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Compensatory Damages for Breach of Warranty of Quality

An Analysis of the Recoverability and Quantification of Compensatory Damages under the Sale of Goods Act, the American Uniform Commercial Code and the United Nations Convention on the International Sale of Goods

Aymen Khaled Masa'deh

A thesis submitted to the University of Bristol in accordance with the requirements of the degree of Ph.D. in the Faculty of Law

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Abstract

Within the last decade, there has been a rapid development in the area of damages in English Law. For example, subsales have been considered for the purpose of assessing the buyer's damages for breach of warranty of quality (*Bence Graphics International Ltd. v. Fasson UK Ltd* 1997); the exception to the privity requirement that the promisee may, in certain cases, recover damages for losses suffered by a third party has been extended to apply to construction cases (*St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.* 1994); it has been made clear that the recovery of damages for cost of cure, which exceeds the diminution in value resulting from defective performance, is subject to the reasonableness restriction and the intention to cure is *only* an evidence of the reasonableness (*Ruxley Electronics and Construction Ltd. and another v. Forsyth.* 1996). Although this thesis is concerned with sale of goods, the applicability of rules, developed in other areas of contract law, to cases of defective goods is examined in this thesis.

In view of such a development, the thesis deals with certain issues that may rise in applying the principle of *Robinson v. Harman* (1848) in cases of breach of warranty of quality. The thesis argues against the opinion that subsales should be disregarded in calculating the buyer's damages for breach of warranty of quality. Although the buyer's damages for breach of warranty of quality are normally calculated on the basis of the diminution in value of goods, such a measure should be displaced in certain cases. In awarding the buyer damages for diminution in value, the issue becomes whether the goods should be valued subjectively or objectively. Calculation of damages in cases of profit-making goods requires a consideration of certain factors such as the productive capacity, the salvage value and the annual earnings. The thesis develops formulas to deal with the quantification of damages in cases of defective profit-making goods. The recoverability of damages for certain losses, such as mental distress, is open to debate. In examining the recoverability of damages for non-pecuniary losses resulting from breach of warranty of quality, the thesis pays special attention to the decision in *Malik v. BCCI* (1998). It should be noted that the thesis starts with examining the recoverability of damages for 'loss of the right to reject' due to the nature of such a loss as distinguished from other losses that may result in cases of defective goods.

The thesis continues to deal with the manufacturer's liability for defective goods. Save in certain cases where a ground for collateral contract can be found, the buyer may not be able to sue the remote seller, i.e. the seller who is not in a direct contractual relationship with the buyer, for breach of warranty due to the lack of privity. The American Uniform Commercial Code is being revised in order to include provisions concerning the enforceability of the remote sellers' warranties. Comparing with American law seems to be encouraging to argue that the remote seller, at least in certain cases, should be contractually liable to the ultimate buyer for defective goods. Moreover, cases decided under the American Uniform Commercial Code are considered in discussing the issues raised in this thesis. Where different attitudes can be found under English and American law regarding certain issues, such a difference is examined in order to provide solutions for such issues. The thesis takes a further step to deal with the United Nations Convention on the International Sale of Goods 1980. The applicability of the Convention to certain cases of defective goods is uncertain. The restrictions imposed on the recovery of damages under the Convention are considered in order to find out the extent to which the Convention departs from the English and American jurisdictions in the area of damages.

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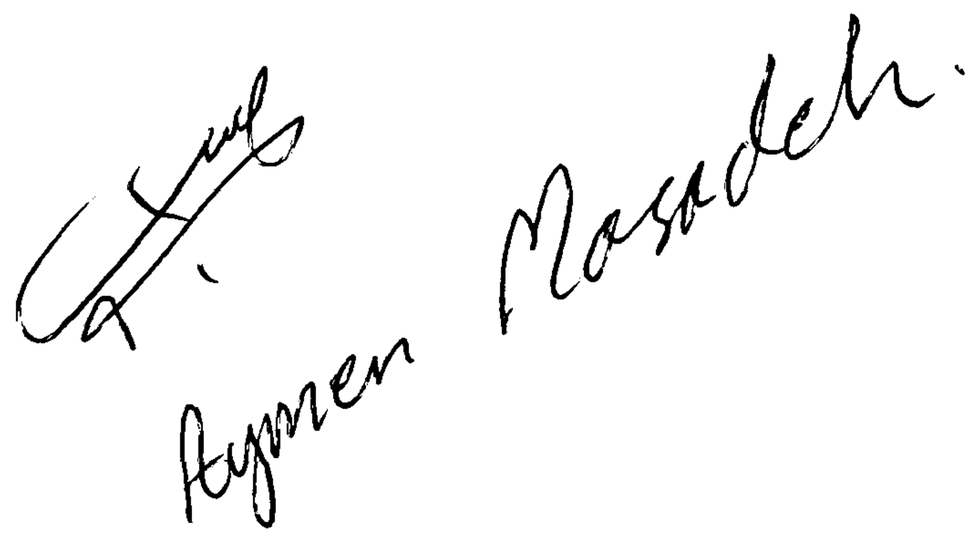
Finally, I must not fail to express the gratitude I owe my parents. Their support and love made it possible for me to reach this point in my life.

To my parents.... Khalid and Arifah

I declare that the work in this thesis was carried out in accordance with the Regulations of the University of Bristol. The work is original except where indicated by special reference in the text and no part of the thesis has been submitted for any other degree.

Any views expressed in the thesis are those of the author and in no way represent those of the University of Bristol.

The thesis has not been presented to any other University for examination either in the United kingdom or overseas.



LIST OF ABBREVIATIONS

AC	Appeal Cases.
Akron L. Rev.	Akron Law Review.
Alb. L. Rev.	Albany Law Review.
All ER	All England Law Reports.
Am. J. Comp. L.	The American Journal of Comparative Law.
Ariz. L. Rev.	Arizona Law Review.
Ariz. St. L.J.	Arizona State Law Journal.
Auckland U. L. Rev.	Auckland University Law Review.
Austl L.J.	Australian Law Journal.
B.C. L. Rev.	Boston College Law Review.
B.U. L. Rev.	Boston University Law Review.
Baylor L. Rev.	Baylor Law Review.
C.P.	Common Pleas Reports.
Cal. L. Rev.	California Law Review.
Cal. W. L. Rev.	California Western Law Review.
Can. Bar Rev.	Canadian Bar Review.
Can. Bus. L.J.	Canadian Business Law Journal.
Ch.	Chancery Law Reports.
CISG (or the Convention)	United Nations Convention on the International Sale of Goods 1980.
CLJ	Cambridge Law Journal.
Colum. L. Rev.	Columbia Law Review.
Com. Cas.	Commercial Cases.
Conn. L. Rev.	Connecticut Law Review.
Consum. L.J.	Consumer Law Journal.
Conv. & Prop. Law.	The Conveyancer and Property Lawyer.
Cornell Int'l L.J.	Cornell International Law Journal.
Cornell L. Rev.	Cornell Law Review.
CPA	Consumer Protection Act 1987.
Creighton L. R.	Creighton Law Review.
Cumb. L. Rev.	Cumberland Law Review.
DePaul Bus. L.J.	DePaul Business Law Journal.
Dick. L. Rev.	Dickinson Law Review.
ER	English Reports.
Exch.	Exchequer Law Reports.
Fordham L. Rev.	Fordham Law Review.
Geo. Wash. J. Int'l L. & Econ.	George Washington Journal of International Law and Economics.
H. & N.	Hurlstone & Norman's Exchequer Reports (156-8 ER).
ICLQ	International and Comparative Law Quarterly.
Idaho L. Rev.	Idaho Law Review.
Ind. L.J.	Indiana Law Journal.
Int'l Tax & Bus. Law.	International Tax and Business Lawyer.
J. L. & Com.	Journal of Law and Commerce.

J. Legal stud.	Journal of Legal Studies.
J. Marshall L. Rev.	The John Marshall Law Review.
JBL	Journal of Business Law.
JCR	Journal of Contract Law.
Jur. Rev.	Juridical Review.
KB	King's Bench Law Reports.
La. L. Rev.	Louisiana Law Review.
Lloyd's Rep.	Lloyd's Law Reports.
LMCLQ	Lloyd's Maritime & Commercial Law Quarterly.
LQR	Law Quarterly Review.
L.S.	Legal Studies.
Marq. L. Rev.	Marquette Law Review.
Mass. L. Rev.	Massachusetts Law Review.
Miss. L.J.	Mississippi Law Journal.
MLR	Modern Law Review.
Mo. L. Rev.	Missouri Law Review.
NILQ	Northern Ireland Legal Quarterly.
N.C. L. Rev.	North Carolina Law Review.
N.Z. Recent L. Rev.	New Zealand Recent Law Review.
N.Z.U. L. Rev.	New Zealand Universities Law Review.
Nw. J. Int'l L. & Bus.	Northwestern Journal of International Law & Business.
O.J.L.S.	Oxford Journal of Legal Studies.
Ohio St. L.J.	Ohio State Law Journal.
Pace Int'l L. Rev.	Pace International Law Review.
Pepp. L. Rev.	Pepperdine Law Review.
QB	Queen's Bench Law Reports.
RTR	Road Traffics Reports.
S. Cal. L. Rev.	South California Law Review.
S.J.	Solicitors Journal.
SGA	(UK) Sale of Goods Act.
St. Mary's L.J.	St. Mary's Law Journal.
Suffolk U. L. Rev.	Suffolk University Law Review.
Temp. L. Rev.	Temple Law Review.
Tex. B. J.	Texas Bar Journal.
Tex. Tech. L. Rev.	Texas Tech Law Review.
The Draft	The (March 2000) Draft of the Revised Article Two of the UCC.
TLR	The Times Law Reports.
U. Miami. L. Rev.	University of Miami Law Review.
U. Pa. J. Int'l Bus. L.	University of Pennsylvania Journal of International Business Law.
U. Tol. L. Rev.	University of Toledo Law Review.
UCC	(US) Uniform Commercial Code.
UCC L.J.	Uniform Commercial Code Law Journal.
UCC Rep. Serv.	Uniform Commercial Code Report Service.
UCLA L. Rev.	UCLA Law Review.
Va. J. Int'l L.	Virginia Journal of International Law.
Va. L. Rev.	Virginia Law Review.

W. Va. L. Rev.	West Virginia Law Review.
Wash. U. L. Q.	Washington University Law Quarterly.
Wayne L. Rev.	Wayne Law Review.
Web JCLI	Web Journal of Contract Legal Issues; available at <http://webjcli.ncl.ac.uk>
Wis. L. Rev.	Wisconsin Law Review.
WLR	Weekly Law Reports.
Yale J. Int'l L.	Yale Journal of International Law.
Yale L.J.	The Yale Law Journal.

CONTENTS

Chapter Three

Recoverability of Damages for Diminution in Value: Displacement of the *Prima Facie* Measure

Chapter Seven

Defences to Warranty Actions

Chapter One

Introductory Remarks

Compensatory damages can be awarded for several types of loss resulting from breach of warranty of quality. After stating the aim and scope of this thesis, this chapter will continue to state the terminology adopted in this thesis for the classification of such losses. In addition, the last section of this chapter will provide a synopsis of significant issues dealt with in this thesis.

1.1 The Aim of the Thesis

The purpose of compensatory damages was stated in *Robinson v. Harman*.[1] In this case, Parke B said that "[t]he rule of the common law is that where a party sustains a loss by reason of breach of contract he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."[2] In order to attain this purpose, the aggrieved party should be entitled to recover for the actual losses he suffered due to the breach. In cases of breach of warranty of quality, the buyer may suffer several losses, such as diminution in value of the goods supplied, consequential loss of profit, expenses wasted or caused by the breach, etc.

In applying the principle of *Robinson*, the court should ensure that the seller is held liable for the losses caused by his breach. Here, two main points should not be ignored in applying the principle of *Robinson*. Firstly, the court has to take into account other principles concerned with the recoverability and quantification of damages, such as remoteness and mitigation.[3] The application of such principles may reduce the buyer's damages. Secondly, in certain cases, awarding the buyer for all kinds of damage resulting from the breach may overcompensate him. In this thesis, a distinction will be drawn between the kinds of damage caused by the breach and the actual loss caused by the breach.[4] It will be argued that in order to achieve the objective of damages stated in *Robinson*, one should consider the actual loss suffered by the buyer and not all the

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[1] (1848) 1 Exch 850.
[2] Ibid, p.855.
[3] Refer to chapter 7 at p.277.
[4] Infra, pp.91-2.

negative results of the breach. The obvious example, discussed in this thesis on this point, is where the defective goods are used as ingredients in manufacturing other products. In such a case, the buyer should not be entitled to damages for both of the diminution in value of the goods supplied and the diminution in value of the products manufactured.[5] In order to avoid overcompensating or undercompensating the buyer, this work will develop methods that can be considered in quantifying damages for breach of warranty of quality in order to ensure that the objective of compensatory damages, stated in *Robinson,* is achieved.

In the area of quantification of compensatory damages, the balance for the law is to ensure that the objective of damages, as stated in Robinson, is achieved whilst at the same time the buyer is not overcompensated, taking into account other principles concerned with the quantification and recoverability of damages. The purpose of this research is to evaluate whether or not the law strikes the right balance in assessing damages for breach of warranty of quality and whether the application of the principle of Robinson is undermined by applying, or misapplying, other principles developed in the area of damages.

As this work deals with the recoverability as well as the quantification of damages, it may make sense to consider, to some extent, the question of whether the ultimate buyer can recover damages from the remote seller, i.e. a seller in the distribution chain who is not privy to the ultimate purchase contract, for the defective quality of goods. Similarly, consideration should be given to the question of whether the third party who is affected by the defective quality of the goods can recover damages from the retailer or the remote seller. The significance of dealing with such questions is, firstly, to ensure that there are no uncompensated losses and, secondly, to ensure that the person responsible for losses bears liability for it.

The objective of compensatory damages under the American Uniform Commercial Code (henceforth the UCC) [6] and the United Nations Convention on the International

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[5] This point is examined in detail in chapter three, infra at pp.94-5.

[6] The Sections of the UCC, which will be considered in this thesis, have been adopted under all the American jurisdictions except Louisiana. However, in Louisiana, the applicable rules regarding the recoverability and quantification of damages in cases of breach of warranty of quality are similar to those stated under the UCC. See W.H. Henning and W.H. Lawrence, *the Law of Sales under the Uniform Commercial Code*, 1992, para.1.01.

Sale of Goods 1980 (henceforth the CISG) is the same objective stated in *Robinson.* As will be discussed in this thesis, the SGA, the UCC and the CISG award the buyer damages for the losses resulting from defective goods. By allowing the buyer damages for his losses, he may be put in the same position as if the goods had been free from defects. However, care must be taken to avoid double recovery for the same loss. The large number of cases decided under the UCC make it possible to see whether American law strikes the right balance in assessing damages for breach of warranty of quality by ensuring that the objective of damages is achieved and at the same time the buyer is not overcompensated. In drawing a comparison between the English and American jurisdictions, it will be seen that the rules of compensatory damages under both the Sale of Goods Act (henceforth the SGA) and the UCC are, to a certain extent, similar.

The method of comparison adopted in this thesis is as follows. Where there is no difference between English and American jurisdictions, it becomes possible to deal with English and American cases together. Indeed, it is quite often that the American courts refer to English cases. However, this would not happen where there is a difference between English and American jurisdictions. As will be seen, damages for certain kinds of loss, resulting from breach of warranty of quality, may be recovered under the SGA and not under the UCC or vice versa. In such a case, American and English cases will be examined separately. In this thesis, where there is a difference between English and American law regarding an issue, the difference will be dealt with in order to conclude which law deals better with such an issue. Such a comparison may provide help to eventually find out whether or not English law strikes the right balance in assessing compensatory damages for breach of warranty of quality.

As regards the CISG, it seems hard to draw a comparison between the SGA and the UCC on the one hand and the CISG on the other hand regarding each issue raised in this thesis due to two main reasons. Firstly, many questions discussed under the SGA and the UCC may not arise under the CISG due to its limited scope. The obvious example here is the recoverability of damages for non-pecuniary losses. Secondly, since the CISG is relatively recent, the number of cases decided under the CISG is relatively small. Therefore, one may not be able to go beyond analysing its own provisions. Nevertheless, this work will seek to find out, so far as possible, the extent to which the CISG departs from the English and American jurisdictions and whether or not such a difference

affects the objective of awarding compensatory damages. For example, although the SGA, the UCC and the CISG impose, to some extent, similar restrictions on the recovery of damages, the thesis will argue that the application of such restrictions may vary. It is intended to explain how such a difference in application may affect the quantification of damages for breach of warranty of quality.

1.2 The Scope of the Thesis

Fuller and Perdue state that contract damages are awarded to protect three interests, i.e. expectation, reliance and restitution.[7] Awarding the aggrieved party the value of the expectancy under the contract can protect the expectation interest. However, in certain cases, as discussed in chapter four, the aggrieved party may seek to recover, as damages, the expenses incurred in reliance on the contract. Fuller and Perdue call the interest protected here the reliance interest. Lastly, the aggrieved party may be entitled to restitution, i.e. to recover what he has paid over to the other party in pursuance of the contract. Such a recovery can be in a restitutionary action where the contract is rescinded. Ogus adds the indemnity interest to such a classification.[8] Under the indemnity interest, the aggrieved party may recover for his liability to a third party.

In this research, it is intended to examine the recoverability and quantification of damages in cases where breach of warranty of quality causes expectation or reliance loss. In fact, the classification of Fuller and Perdue has been relied on by respected writers, such as Ogus, to conclude that damages should not be recoverable for wasted pre-contract expenses. This thesis will argue that such writers, with many respects, misapplied the classification of Fuller and Perdue.

It should be noted that the examination of the concept of 'warranty of quality' is not within the scope of this thesis. This work presumes that the breach of warranty of quality is not in dispute or the buyer has sufficiently proved it. Clearly, this work presumes further that the buyer retains the defective goods. In cases where the buyer rejects defective goods, he may be entitled to damages for non-delivery, as explained in chapter two. Damages for non-delivery are clearly beyond the scope of this thesis. Under the UCC the buyer may, in certain cases, revoke his acceptance of goods. As

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[7] L.L. Fuller and W.R. Perdue, Jr., 'The Reliance Interest in Contract Damages' (1936) 46 *Yale L.J.* 52.

explained in chapter two, where the buyer rightfully revokes his acceptance, he may be entitled to damages for non-delivery.

The term 'warranty of quality' is used to mean that the seller warrants the goods to be of satisfactory quality.[9] The research will deal with compensatory damages for breach of implied and express warranties that are concerned with the quality of goods. The arguments developed in this thesis can apply similarly to cases of 'fitness for particular purpose',[10] 'sale by sample'[11] and 'sale by description'[12] where the description is concerned with the quality of goods.

This thesis is concerned with consumer and commercial sales. The distinction between consumer and commercial cases will be necessary where different opinions may be stated depending on the kind of transaction. In addition, construction cases will be considered in order to provide authority where sale of goods cases are unavailable. As will be explained, the results reached in discussing certain issues raised in construction cases will apply similarly to sale of goods cases. For example, construction cases seem to be helpful in discussing the recoverability of cost of cure, as discussed in chapter three.

1.3 Terminology

This thesis adopts the terminology used by McGregor[13] for the purpose of examining the remedy of damages. Losses resulting from breach of warranty of quality can be classified as normal and consequential.[14] Normal loss,[15] for the purpose of this research, is the diminution in value of the goods. Diminution in value occurs usually where the goods are not of a satisfactory quality, do not correspond to their description or are not fit for specific use agreed on by the parties. The measure of damages for normal loss is

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[8] Ogus, *The Law of Damages*, London, 1973, p.354.
[9] See Sections 14(2) of the SGA, 2-314 of the UCC and Article 35(2-a) of the CISG.
[10] See Sections 14(3) of the SGA, 2-315 of the UCC and Article 35(2-b) of the CISG.
[11] See Sections 15 of the SGA, 2-313(1-c) of the UCC and Article 35(2-c) of the CISG.
[12] See Sections 13 of the SGA, 2-313(1-a) of the UCC and Article 35(1) of the CISG.
[13] Harvey McGregor, *McGregor on Damages,* 16th ed., 1997, p.20.
[14] In drawing the distinction between normal and consequential losses, McGregor relies on the decision in *Mondel v. Steel* (1841) 8 M. & W. 858. In this case, Parke B., at p.870, made it clear that in an action for damages for the defective performance of a contract for goods sold or service, the plaintiff may recover "as well the difference between the price contracted for and the real value of the articles or the work done, as any consequential damage, might have been recovered...". Harvey McGregor, ibid at p.21.
[15] Normal loss may also be referred to as general or primary loss.

the difference between the value of the goods as defective and the value they would have had if they had been free from defects. The ceiling of recovery for normal loss is the value of the goods as warranted. Normal loss is integrally different from consequential losses which have nothing to do with the decline in value of the goods supplied. Generally, consequential losses do not concern the value of the goods themselves. They result from the use or loss of use of the defective goods, such as loss of profit, loss of goodwill, extra expenses, liability towards third party, personal injuries caused to the buyer, etc. While the amount of normal loss can, to some extent, be predictable since it cannot exceed the value of the goods as warranted, consequential losses may not be predictable as to their amount and can greatly exceed the value of the goods as warranted.

It should be noted that in the context of contractual exclusions of liability, the classification of McGregor seems not to be accepted. This was best explained by the decision in *Croudace Construction Ltd. v. Cawoods Concrete Products Ltd.*[16] where the buyers sought to recover damages for late delivery. The sellers relied on an express term to the contract, which excluded their liability for consequential losses. The Court of Appeal rejected the argument that consequential losses are those losses other than the difference in value of the goods "as between the date when the goods should have been delivered under the contract and the date when they were in fact delivered"[17]. Under the classification of McGregor, consequential loss can be any loss other than the difference in value. Obviously, the Court had a different view. In this case, the Court referred to consequential losses as those losses resulting under special circumstances. The Court relied on the decision in *Millars Machinery Co. Ltd. v. David Way and Son*[18] where it was held that consequential losses do not include those losses which result directly and naturally from breach of contract.

A similar interpretation of consequential losses in the context of exclusion clauses can be found in the decision of the Court of Appeal in *British Sugar plc v. NEI Power Projects Ltd and Another.*[19] In this case, the sellers were in breach of contract by supplying defective electrical equipment to the buyers. The buyers sought to recover, as

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[16] [1978] 2 Lloyd's Rep. 55.
[17] Ibid, pp.61-2.
[18] [1934] 40 Com. Cas. 204.
[19] [1997] 87 BLR 42.

damages, the increased production costs and loss of profits due to the breakdowns. The sellers relied on an express term to the contract which limited their liability for consequential losses to the value of the contract that was much less than the claimed damages. The sellers relied on the view of McGregor to argue that the increased production costs and lost profits were elements of consequential loss. Such an argument was rejected by the Court. The Court decided that such losses are not consequential losses as they were a natural and direct result of the breach. Obviously, the Court limited consequential losses to those losses which were as an indirect result of the breach.[20]

However, it is still hard to decide whether the loss is a direct or an indirect result of the breach. In *Saint Line Ltd. v. Richardson, Westgarth & Co. Ltd.*,[21] Atkinson J. said "what does one mean by 'direct damage'? Direct damage is that which flows naturally from the breach without other intervening causes and independently of special circumstances, while indirect damage does not so flow."[22] In this view, losses, such as lost profit and expenses incurred or wasted by breach of warranty of quality, resulting under normal circumstances may not be kinds of consequential loss. The term 'consequential losses' is confined to those losses resulting under special circumstances.

This was decided by the Court of Appeal in the recent case of *Hotel Services Ltd. v. Hilton International Hotels (UK) Ltd.*[23] In this case, the defendant delivered Robobar to the plaintiff (Hilton Hotels) under a hire contract. The purpose of using the Robor was to make the guests automatically billed on their account for removal of any of the Robobar's contents. The Robobar proved defective. The plaintiff sought to recover, among others, the loss of profit resulting from the use of the Robobar and the cost of removal and storage of chiller units and cabinets. The defendant argued that such losses were excluded from his liability by an express term to the contract which excluded liability for consequential losses. Such an argument was rejected by the Court on the grounds that consequential losses are those which result under special circumstances. The Court was not convinced of McGregor's view that consequential losses may result under normal circumstances.[24]

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[20] Ibid, p.51.
[21] [1940] 2 KB 99.
[22] Ibid, p.103.
[23] [2000] BLR 235.
[24] Ibid, p.239. In this case, the Court, at p.239, refused to follow the plaintiff's submission that "in *Hosier & Dickinson Ltd v P & M Kaye Ltd* [1972] 1 WLR 146, one sees Lord Morris of Borth-y-Gest (at 153),

In order to avoid any unexpected interpretation of the term 'consequential loss', it seems better to state expressly in the exclusion clause the exact nature of the loss, such as loss of profit or extra expenses, intended to be excluded from the party's liability. For example, the recovery of loss of profit was not allowed in *Deepak Fertilisers and Petrochemicals Corporation v. ICI Chemicals & Polymers Ltd. and Others*[25] due to its express exclusion from the defendant's liability. In this case, the plaintiff owned a modern methanol plant which was built by the aid of technology and know-how deriving from the defendants (ICI plc). The plaintiff contracted with a licensee of that technology (Davy) for the supply of the ICI technology and know-how as well as the provision of other procurement and supervisory services. The methanol converter exploded, due to its defective quality, causing severe damage to the plant and as a result all production ceased. The plaintiff sued Davy and ICI. The plaintiff sought to recover from Davy, among others, the expenses incurred in reconstructing the plant, wasted overhead expenses incurred during the construction and loss of profit. Davy relied on an express term to the contract which excluded its liability for consequential losses and loss of profit. In this case, the Court of Appeal relied on the decision in *Croudace Construction Ltd. v. Cawoods Concrete Products Ltd*[26] to reject the argument that the losses of the plaintiff were kinds of consequential loss.[27] However, the Court did not allow, as damages, the loss of profit since it was excluded expressly from Davy's liability.

It should be clear now that the classification drawn by McGregor between normal and consequential losses is rejected expressly by the Court of Appeal in the context of contractual exclusions of liability. Although this thesis adopts the classification of McGregor, as it provides a convenient way in examining the quantification and recoverability of damages, it must be clear that such a classification does not apply in

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Lord Wilberforce (at 156) and Lord Diplock (at 169) using "consequential" to describe damage in the sense espoused by McGregor." Instead, the Court referred to cases where the term consequential loss was interpreted differently in the context of contractual exclusion of liability such as the cases of *Croudace Construction Ltd. v. Cawoods Concrete Products Ltd* [1978] 2 Lloyd's L. Rep. 55, *Millars Machinery Co. Ltd. v. David Way and Son* [1934] 40 Com. Cas. 204.

[25] [1999] 1 Lloyd's Rep. 387.

[26] [1978] 2 Lloyd's L. Rep. 55. See supra, p.6.

[27] In this case, the Court did not state a definition for consequential losses. It found it enough to rely on the decision in *Croudace Construction Ltd. v. Cawoods Concrete Products Ltd* [1978] 2 Lloyd's L. Rep. 55 to reject the conclusion of the trial judge, at first instance, that loss of profit and overhead expenses are related elements to consequential loss.

cases of exclusion clause. For the purpose of this thesis, consequential loss can be any loss other than the diminution in value. Therefore, losses such as expenses wasted or caused by the breach under normal circumstances can be considered as kinds of consequential loss. However, in the context of contractual exclusions of liability, such losses are unlikely to be considered as consequential losses since the term 'consequential losses' is confined to those losses resulting under special circumstances. This is unlikely to create any confusion in this thesis since exclusion clauses are not within the scope of this work.

As regards the UCC, provisions concerned with damages classify losses as three types, i.e. normal, consequential and incidental.[28] Cases decided under the UCC usually refer to the diminution in value of the goods supplied as the normal loss.[29] Chapter two of this thesis will define incidental loss and hopefully make it clear that such a loss can be dealt with as consequential loss under the SGA and the CISG. Regarding the CISG, Article 74 awards damages for all losses resulting from breach of warranty of quality as long as such damages comply with the restrictions stated in the Convention. The CISG does not distinguish expressly between normal and consequential losses. However, it can be mentioned here that the distinction between normal and consequential losses, adopted in this thesis, seems to be consistent with the Articles of the CISG. In fact, the CISG, as mentioned below, does not provide a measure of damages for breach of warranty of quality. However, Article 75 which deals with compensatory damages in cases of avoidance of contract, awards "the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74." Actually, the term "further damages" may be interpreted as damages for consequential losses since the first part of the award is obviously for the normal loss resulting from non-delivery or non-acceptance of goods. For the purpose of this thesis, the term 'consequential loss' will be used, in all cases, to mean losses other than the diminution in value of the goods supplied.

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[28] See Sections 2-714 & 2-715 of the UCC discussed in chapters 3 & 4.
[29] Section 2-714(2) of the UCC.

1.4 Synopsis of Issues Discussed in the Thesis

The topic of this thesis has developed from the case of *Bence Graphics International Ltd. v. Fasson UK Ltd.*[30] In this case, the question was whether the buyer's damages should be calculated on the basis of the diminution in value of the goods supplied or on the basis of the buyer's liability to his sub-buyers. The Court of Appeal held that in cases of resale, the buyer's damages should be assessed on the basis of his liability to the sub-buyers. The decision in *Bence* seems in direct contradiction with the decision of the same Court in *Slater v. Hoyle & Smith Ltd.*[31] where the subsale contracts were not taken into consideration for the purpose of calculation of damages. Furthermore, the decision in *Bence* has been criticised on the ground that such a decision may undercompensate the buyer. Nevertheless, chapter three of this work will produce an argument to support the decision in *Bence* and show that the Court misdirected itself in *Slater*.

Where the buyer is entitled to recover for the diminution in value, damages may be calculated under a *prima facie* measure, stated in the SGA and the UCC (henceforth the *prima facie* measure).[32] Such a measure does not exist under the CISG. Therefore, one may need to find out how damages for breach of warranty of quality can be quantified under the CISG. Under the *prima facie* measure, the buyer is entitled to recover the difference between the value of the goods as defective and the value they would have had if they had been as warranted. Normally, the goods are valued objectively. The question here is whether the subjective value of the goods can be considered for the purpose of calculating the buyer's damages under the *prima facie* measure. Chapter three will argue that the subjective value should be considered, in certain cases, for the purpose of calculating damages. Therefore, the issue of whether the buyer is entitled to recover for loss of "consumer surplus" cannot be avoided.

The *prima facie* measure can be displaced in certain cases. One of these cases is where damages are calculated on the basis of the buyer's liability to the sub-buyers, as in the case of *Bence.* Furthermore, the *prima facie* measure can be displaced in cases where the court entitles the buyer to recover the cost of cure of defective goods. Usually, the cost of cure equals the diminution in value of the defective goods. Where the cost of cure

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[30] [1997] 1 All ER 979.
[31] [1920] 2 KB 11.

exceeds or is less than the diminution in value, on which basis can the buyer's damages be calculated? In answering this question, chapter three will examine the decision of the House of Lords in *Ruxley Electronics and Construction Ltd. and another v. Forsyth.*[33] In this case, the House of Lords considered the restriction of reasonableness which is imposed on the recovery of cost of cure. Therefore, the examination of this case is significant.

In awarding the cost of replacement of the defective goods, the court should take into account the superiority of the substitute goods. Chapter three will produce a formula to deal with the calculation of damages in cases where the substitute goods are superior to the defective goods. Furthermore, the commercial life of the substitute goods may be longer than the remainder of the potential commercial life of the replaced goods. Chapter three will argue that the commercial life of substitute goods should be taken into account for the purpose of calculating the buyer's damages. In fact, such a commercial life was disregarded in *Bacon v. Cooper (Metals) Ltd.*[34] However, it will be argued that the case of *Bacon* was decided on its own facts.

The *prima facie* measure may also be displaced by means other than the cost of cure. It is hoped that chapter three will prove that the *prima facie* measure should be displaced in cases where the defective goods were used to produce goods which, as a result, appeared defective. It will be seen that a number of UCC cases, such as *Durham v. Ciba-Geigy Corp.*[35] and *Albin Elevator Co. v. Pavlica,*[36] were decided wrongly by awarding the buyer for both the diminution in value of the defective goods and the loss of products made by using the defective goods. In such UCC cases, the buyer was overcompensated. Furthermore, it will be seen that the buyer should not be allowed to recover for both the diminution in value of a chattel and loss of its potential production.

One of the crucial cases of calculation of damages is the case of loss of profit. The main question is whether damages can be awarded for diminution in value and consequential loss of profit. The answer to this question depends on whether the profit is defined as gross earnings or net profit. Chapter three will argue that in a number of UCC cases the

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[32] Sections 53(3) of the SGA and 2-714(2) of the UCC.
[33] [1996] 1 AC 344.
[34] [1982] 1 All ER 397.
[35] 1982 S.D. LEXIS 262; 33 UCC Rep. Serv. 588 (1982).

buyer was overcompensated by recovering damages for the diminution in value and loss of gross earnings. However, it is hoped to prove, in chapter four, that the buyer may be entitled to recover for the loss of net profit, diminution in value and any expenses wasted by the seller's breach of warranty of quality. The chapter will argue that the decision in *Cullinane v. British "Rema" Manufacturing Co. Ltd.*[37] undercompensated the buyer.

Calculation of loss of profit may not be an easy task, especially in cases of profit-making goods. In such cases, many factors, such as the productive capacity, the salvage value and annual earnings, have to be taken into account. Furthermore, the buyer may lose the chance of investing the annual earnings that he would have earned but for the seller's breach. Chapter four will develop a formula to deal with the quantification of loss of profit in cases of profit-making goods.

Breach of warranty of quality may cause a delay in the operation of the buyer's business. The buyer may be entitled to recover for loss of profit resulting from such a delay. Chapter four will deal with the recoverability and quantification of loss of profit in such cases. Also, breach of warranty of quality may result in a loss of goodwill which is likely to cause loss of profit. Such a loss is too speculative and hard to quantify. Chapter four will provide a way to quantify damages for loss of goodwill.

The main restriction imposed upon the recovery of damages for loss of profit is certainty. Chapter four will deal with the degree of certainty required in proving the fact and amount of loss of profit. The requirement of certainty has been applied strictly by the American courts. The so-called "new business rule" was applied to prevent recovery of damages for loss of profit in most cases of new business. The rule has been justified on the ground that new businesses have no previous records of profit and, thus, loss of profit cannot be proved reasonably certain. The rule is still influential in the American courts. Such a rule does not exist under English law. Chapter four will argue that the application of such a rule may lead to unfair results in certain cases.

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[36] 1982 Wyo. LEXIS 358; 34 UCC Rep. Serv. 438 (1982).
[37] [1954] 1 QB 292.

Where the buyer does not suffer or cannot prove loss of profit, he may sue the seller for the reliance expenses wasted by breach. It should be noted that the buyer may not be entitled to recover all his capital expenses if the seller proves that the capital expenses exceed the buyer's potential gross earning, i.e. where the buyer has made a bad bargain. The main question is whether the buyer is entitled to recover, as damages, his lost pre-contract expenses. In answering this question, the view of English law seems to be different from the view of American law. It seems necessary to look at the justifications of both views before deciding whether or not damages for loss of pre-contract expenses should be recoverable.

Breach of warranty of quality may result in physical loss suffered by the buyer. Under the English and American law, where physical loss results from breach of a contract, the aggrieved party may have the choice to sue in tort, contract or both. However, this may not be the case under contracts governed by the CISG. Where physical loss results from the breach of such contracts, the question of whether the buyer has a choice to bring a contract action under the CISG or a tort action under the applicable domestic law is open to debate. Chapter five will participate in such a debate in order to reach a conclusion regarding this issue.

Furthermore, under both English and American law, where physical loss results from breach of warranty of quality, the recoverability of damages for such a loss in a contract action seems to be beyond question. However, this may not be the case under the CISG. The CISG may not apply to cases of certain types of physical loss. In such cases, the buyer may bring an action under the applicable domestic law. Chapter five will deal with the applicability of the Convention to cases of physical loss resulting from breach of warranty of quality.

The buyer, in making his choice to sue in tort or contract, should take into account the remoteness principle. Under English law, the remoteness principle seems to apply in contract and in tort differently. It will be argued in chapter five that the difference in the application of the principle may lead to unfavourable results. The UCC applies the tort test to cases of physical loss resulting from breach of contract. The UCC does not apply the remoteness principle to cases of physical loss. Chapter five will examine the

approach of the UCC in order to find out whether or not it is favourable in cases of physical loss.

Chapter five is mainly concerned with the recoverability of damages for non-pecuniary losses, such as physical inconvenience, disappointment, distress, frustration, anxiety, displeasure, vexation and tension, resulting from breach of contract. In certain cases, the recoverability of such damages is well settled. However, in most cases, the English and American courts do not have a coherent approach regarding the recoverability of such damages. The question here is whether such damages should be allowed in cases of breach of warranty of quality. In answering this question, chapter five will distinguish between consumer and commercial cases. The chapter will pay special attention to the view of Lord Steyn in *Malik v. BCCI*[38] which is thought to be of great significance. As for the CISG, chapter five will show that the issue is beyond its scope.

After dealing with the recoverability and quantification of damages for breach of warranty of quality in chapters three, four and five, chapter six will deal with one of the main defences that can be raised by the seller against the buyer's action. Buyers may be unaware of the defective quality of the goods that they sell to sub-buyers. Where the sub-buyer suffers physical loss, he may bring an action in tort against the original seller. Such an action is not available in cases of economic loss unless such a loss is a consequence of physical damage. Where the sub-buyer suffers purely economic loss resulting from the defective quality of goods, the question becomes whether the sub-buyer can bring a contract action against the original seller.

Under English law, the ultimate buyer may not be entitled to bring a contract action against the remote seller, i.e. the manufacturer, the wholesaler or the distributor, due to the requirement of privity. In chain contracts, liability may be shifted up the chain until it reaches the remote seller. However, chapter six will argue that the method of passing the liability up the chain may be deficient in certain cases. Furthermore, such a method may be inapplicable where the chain is broken. Some of the American jurisdictions avoid such a method by relaxing the rigour of the requirement of privity. In certain cases, such jurisdictions allow the ultimate buyer to file a claim in contract against the

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[38] [1998] AC 20.

original seller. It is intended to find out whether the remote seller should be liable for losses suffered by the ultimate buyer due to breach of warranty.

Furthermore, chapter six is also concerned with the enforceability of the remote seller's express warranty issued to the ultimate buyer. The remote seller may warrant the quality of their products through advertisements in order to promote their purchase. The manufacturer may also issue a warranty, packaged with or accompanying the goods, to the ultimate buyer. In general, such warranties may not be enforceable due to the lack of a direct contractual relationship between the remote seller and the ultimate buyer. However, as will be discussed, the remote seller's warranty issued to the ultimate buyer may furnish a ground for collateral contract between the remote seller and the ultimate buyer. Nevertheless, chapter six will argue that the remote seller's warranty should be enforceable in all cases regardless of whether or not such a warranty furnishes a ground for collateral contract. Although the UCC does not deal with the remote seller's warranty issued to the ultimate buyer, chapter six will show that such a warranty is enforceable under the American jurisdictions. In fact, the draft[39] of the revised Article 2 of the UCC provides expressly that the remote seller's express warranty issued to the ultimate buyer is enforceable.

Breach of warranty of quality may result in a loss suffered by a beneficiary other than the ultimate buyer, such as a hirer of the goods, a member of the buyer's family, an employee of the buyer, a visitor, etc. The question here is whether such a beneficiary can bring a contract action against the retailer or the remote seller. In answering this question, one needs to deal with the Contracts (Rights of Third Parties) Act 1999. Here, can the case of *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.*[40] be relied on in order to allow the buyer to recover damages for losses suffered by a third party beneficiary due to the defective quality of goods? The UCC provides a specific section to deal with this question. Chapter six will deal with this section in order to conclude whether such a beneficiary should be allowed to bring a contract action against the retailer or the remote seller.

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[39] The draft of March 2000.
[40] [1994] 1 AC 85.

The last chapter of this thesis is concerned with the seller's defences against the buyer's claim for damages for losses resulting from breach of warranty of quality. The seller may be able to prove that the loss could have reasonably been avoided or it has not resulted from the breach of warranty of quality or it is too remote. Furthermore, under both the UCC and the CISG, the buyer is required to notify the seller of non-conformity of goods within a reasonable time after the discovery of the breach. Such a requirement does not exist under English law in cases where the buyer retains the defective goods and claims damages. Chapter seven will deal with the significance of such notification in order to find out whether or not it is desirable to adopt the requirement of notification under English law.

Some of the seller's defences will be taken into consideration in dealing with issues raised in the following chapters. Here, it should be noted that the purpose of chapter seven is, firstly, to examine the application of the defences mentioned to cases of breach of warranty of quality. The application of such defences to cases other than breach of warranty of quality is beyond the scope of this research. The second purpose of chapter seven is to state the differences in the application of these defences under the SGA, the UCC and the CISG in order to find out how such differences can affect the recoverability of damages for breach of warranty of quality. Moreover, the application of defences, such as causation and notification, may vary widely among the several legal systems. It will be seen how the application of the restrictions imposed on the recovery of damages under the CISG can be influenced by the several legal systems.

The application of restrictions, such as causation, mitigation and remoteness, may raise a number of issues. For example, does the buyer's failure to examine the goods break the causal link between the seller's breach and the buyer's loss? Is the buyer required, under the mitigation principle, to stop using the defective goods after he becomes aware of the defect? Does the mitigation principle require the buyer to accept the seller's offer to repair or replace defective goods? Does the mitigation principle require the buyer to accept the seller's offer to restore the contract price and take the goods back? Furthermore, under the remoteness principle, some points are approached differently under English law, the UCC and the CISG. Such laws seem to disagree on whether the test of remoteness is objective or subjective nor do they agree on whether the principle applies to the kind or the amount of loss.

Chapter Two

Compensatory Damages:

Definition and Classification

Introduction

As this work deals with foreign legislation, it seems necessary to state briefly the origin and historical drafting of the legislation dealt with in this thesis. Moreover, it may be necessary to provide in this chapter an explanation of the concept of compensatory damages since it is the subject area of this research.

The main part of this chapter is concerned with the recoverability and quantification of damages for 'loss of the right to reject'. Since 'loss of the right to reject' is of different nature from other losses that may result in cases of defective goods, it seems convenient to deal with such a loss at this place. The question regarding cases of this loss is whether the court achieved the objective of compensatory damages, as stated in *Robinson v. Harman,*[1] by awarding the buyer damages for the actual losses resulting from the seller's breach. The main argument in this respect is that in a number of cases of 'loss of the right to reject', the buyer was overcompensated by receiving damages for his market loss which did not result from the seller's breach. Before dealing with this point, this chapter will explain what is meant by 'loss of the right to reject' in this research and how it can result in cases of breach of quality warranty.

In addition, this chapter deals with other points that seem necessary to be considered at the beginning of this research. For example, since some arguments, raised in the following chapters, are more concerned with consumer sales than commercial sales, it is convenient to explain at this place that the CISG is unlikely to apply to consumer sales. Another point to be considered at this place is the classification of losses. As explained in the previous chapter, losses resulting from breach of warranty of quality can be classified as normal and consequential. The UCC seems to add another kind of loss, i.e. incidental loss. It is hoped to explain that such a loss is unlikely to result from breach of warranty of quality.

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[1] (1848) 1 Exch 850, 855. Supra, p.1.

2.1 Background to the SGA, the UCC and the CISG

The SGA was enacted in 1979. The purpose of the SGA was to consolidate the law regarding sale of goods by putting in one form the 1893 Sale of Goods Act as it had been amended between 1893 and 1979. Generally, the court, in applying the provisions of the SGA, should not be affected by cases decided before the 1893 Act. This can be understood from the famous statement of Lord Herschell in *Bank of England v. Vagliano Brothers.*[2] He said

> "... the purpose of such a statute was that on any point specifically dealt with by it, the law should be ascertained by interpreting the language used instead of, as before, by roaming over a vast number of authorities in order to discover what the law was, extracting it by a minute critical examination of the prior decision."[3]

However, in practice, the court may refer to cases, decided before the 1893 Act, where the SGA is silent on particular issue.[4] Moreover, where it is generally accepted that a provision in the SGA was intended to give effect of a particular decision or view in a case, the court may refer to such a case. The obvious example in this thesis is Section 53(2) of the SGA. It is generally accepted that Section 53(2) of the SGA was enacted to give effect for the decision in *Hadley v Baxendale.*[5]

In the USA, the American Uniform Sales Act was modelled on the Sale of Goods Act 1893. In 1906, the National Conference of Commissioners on Uniform States Law approved the Uniform Sales Act. After almost 45 years, the Uniform Sales Act was superseded by Article 2 of the UCC. The UCC has been adopted by all the States of the USA except Louisiana. It should be noted that Article 2 departs from the SGA in many aspects of the law of sale of goods. A number of differences between the UCC and the SGA can be found in the area of damages. Some of these differences will be considered in this thesis.

It seems that not every aspect of the law of contract for the sale of goods is codified in the UCC. Where the UCC is silent on particular issue, the court may refer to the original source of contract law, i.e. the common law. Indeed, Section 1-103 of the UCC makes it

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[2] [1891] AC 107. In this case, the Bills of Exchange Act 1882 was applied.
[3] *Bank of England v. Vagliano Brothers* [1891] AC 107, 145.
[4] A. G. Guest, *Benjamin's Sale of Goods,* London, 1997, p.6.
[5] [1854] 9 Exch 341.

clear that the UCC is to be supplemented by general principles of law and equity unless those principles have been displaced by statutes. Since the UCC has been adopted by all the States of the USA, except Louisiana, the court in one State may refer to cases decided in other States. The Sections of the UCC examined in this thesis have been adopted similarly by all the jurisdictions of the USA. Therefore, such Sections should have similar application in all the States of the USA.

Moreover, where the UCC is silent or unclear on particular issue, the court may refer to the Restatement (Second) of Contracts. The original Restatement of Contracts was adopted in 1932. It was superseded by the Restatement (Second) of Contracts in 1979. Although the Restatement is not a controlling source of law, it has a persuasive authority.[6] The Restatement (Second) of Contracts is usually referred to where the UCC is silent or unclear on a particular issue. The obvious example is the recoverability of damages for mental distress as discussed in chapter five of the thesis.[7]

As regards international sale of goods, the CISG seems to be a successful step of uniformity. It can be noted that the CISG originated from two Hague conventions on the international sale of Goods 1964, i.e. Uniform Law for the International Sale of Goods (ULIS) and Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF). The two Hague sales Conventions were the outcome of the efforts of the International Institute for the Unification of Private Law (UNIDROIT) on the unification of the international sales law, which was interrupted by the World War II.[8] In 1968, the United Nations Commission on the International Trade Law (UNCITRAL) started its project on the international sale of goods.[9] The Hague Conventions 1964 were the starting point in drafting the CISG. In 1980, a diplomatic conference held in Vienna established the CISG. The CISG came into force in 1988 after securing the requisite 10 ratification. The CISG has now been adopted by over 50 countries including the United States, China and other several industrialized countries.

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[6] W.H. Henning and W.H. Lawrence, *the Law of Sales under the Uniform Commercial Code*, 1992, para.1.01.
[7] Infra, p.178.
[8] The project started in 1930 with the decision of the International Institute for the Unification of Private Law (UNIDROIT) to appoint a committee of experts to prepare a uniform international sales law. In 1939 the first draft of UNIDROIT sales text was prepared. The process was interrupted by the World War II. In 1950, the UNIDROIT decided to continue its process in unifying the international sales law. This has lead to the two Hague Conventions 1964. See Nina M. Galston and Hans Smit, *International Sales: The United Nations Convention on Contracts for the International Sale of Goods,* New York, 1984, para 1.01.
[9] Michael Bridge, *The International Sale of Goods: Law and Practice,* Oxford, 1999, p.41.

The UK has not yet ratified the CISG. Although this thesis is not concerned with examining the possibility and necessity of implementing the CISG in UK, one may note that the UK is becoming isolated in the international trading community as the CISG has been implemented in the major part of Europe and most of the industrialized countries.[10] Any way, Professor Bridge makes it clear that the CISG may apply in UK regardless of the fact that it has not been ratified by UK.[11] The CISG may apply where the applicable law is a law of a Contracting State. Article 1 of the CISG states

"(1) This Convention applies to contracts of sale of goods between parties whose places of business are in different States:
(a) when the States are Contracting States; or
(b) when the rules of private international law lead to the application of the law of a Contracting State.
(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.
(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention."

Therefore, if the applicable law is the law of France, due to a choice of law clause in the contract or the rules of private international law, the CISG will apply even though the case is before a court in England. Furthermore, Arbitration Agreements may lead to the application of the CISG where the law of a Contracting State applies under such an agreement.

2.2 The Applicability of the SGA, the UCC and the CISG to Consumer Sales

The SGA and the UCC are applicable to consumer transactions.[12] The provisions of both the SGA and the UCC are designed to apply to commercial and consumer sales. The Consumer Protection Act 1987 is a tort statute that applies to cases where the buyer suffers physical loss resulting from defective goods. As for American law, the

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[10] The Law commission seems to support the implementation of the CISG in UK. Law Commission, *Thirty-Second Annual Report*, 1997 Law Com. No. 250.
[11] Michael Bridge, supra n.9 at p.39.
[12] Sections 13 and 15 of the SGA apply to all kinds of sale of goods regardless of whether the goods are sold by private or commercial seller. However, the requirement of satisfactory quality and fitness for purpose under Section 14 of the SGA can only arise in cases where the sale is by a business. See *Stevenson v. Rogers* [1999] 1 All ER 613. It is irrelevant whether the goods are sold to a consumer or a commercial buyer.

Magnuson-Moss Warranty Act is concerned with consumer transactions. As this research is concerned with the UCC, the Magnuson-Moss Warranty Act will be dealt with briefly.

2.2.1 Domestic Statutes Applicable to Consumer Sales

The consumer can sue in tort under the Consumer Protection Act 1987 in cases of physical losses resulting from defective products.[13] As explained in chapter six, where the buyer suffers physical loss resulting from breach of warranty of quality, he may have the choice to sue in contract, tort or both. The producer's[14] liability under the Consumer Protection Act is strict in the sense that the buyer does not need to prove negligence. Under the Act, lack of privity cannot be used as a defence for the buyer's claim against the producer. Such a defence can be used where the buyer claims damages for pure economic loss resulting from breach of warranty of quality. Here, where the defendant is not the direct seller, lack of privity may be a successful defence as discussed in chapter six of this thesis.[15]

In the USA, the law has gone a forward step in consumer transactions to make written warranties issued to consumers enforceable. This has been made by a federal statute, i.e. the Magnuson-Moss Warranty Act. The Act regulates the content of written warranties issued to consumers.[16] It regulates mainly the cases where liability can be limited or excluded. It should be noted that Magnuson-Moss Warranty Act does not create any cause of action where a written warranty does not exist.[17] Furthermore, it applies only in

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[13] See Brian W. Harvey and Deborah L. Parry, *The Law of Consumer Protection and Fair Trading,* London, 5th ed., 1996, at p.159. "Product" is defined, by Section 1(2) of part one of the Consumer Protection Act 1987, as "any goods or electricity and (subject to subsection 3 below) includes a product which is comprised in another product, whether by virtue of being a component parts or raw material or otherwise". Subsection 3 provides that "For the purposes of this Part a person who supplies any product in which products are comprised, whether by virtue of being component parts or raw materials or otherwise, shall not be treated by reason only of his supply of that product as supplying any of the products so comprised".

[14] As for the definition of "producer" Section 1(2) of part one of the Consumer Protection Act 1987 provides that "Producers, in relation to a product, means (a) the person who manufactured it; (b) in the case of a substance which has not been manufactured but has been won or abstracted, the person who won or abstracted it; (c) in the case of a product which has not been manufactured, won or abstracted but essential characteristics of which are attributable to an industrial or other process having been carried out (for example, in relation to agricultural produce), the person who carried out that process".

[15] Infra, p.198.

[16] Jonathan Sheldon and Carolyn L. Carter, *Consumer Warranty Law,* National Consumer Law Center, 1997, p.63.

[17] O.F. Harris, Jr. and A.M. Squillante, *Warranty Law in Tort and Contract Actions,* Vol.2, New York, 1989, p.237.

cases where the goods are consumer products and the plaintiff is a consumer. Under the Act, the written warranty can be an affirmation of fact or a written promise relating to the nature of the goods or an undertaking to refund, repair, replace, or take other remedial action with respect to the product "in the event that such product fails to meet the specification set forth in the undertaking".[18]

The Magnuson-Moss Warranty Act does not seem a perfect model for enforcing warranties. Apart from the fact that the Act does not apply to warranties issued to non-consumer buyers, the Act applies only to written warranties. As discussed in chapter six of this work,[19] manufacturers tend to advertise their products in order to promote their sale. The Act is silent with respect to the enforceability of manufacturers' representations made through advertisements. Furthermore, the Act requires such a warranty to be part of the basis of the bargain between a supplier and a buyer for purposes other than resale of the product.[20] Requiring the warranty to be "part of the basis of the bargain" may imply the need for a direct sale contract between the supplier and the consumer. In view of this, where the consumer suffers loss resulting from breach of warranty issued by a remote seller, the Act does not deal with the defence of lack of privity where the consumer sues such a seller for breach of warranty. This problem arises also under the UCC as explained in chapter six of this research.[21]

2.2.2 The Applicability of the CISG to Consumer Sales

Article two of the CISG seems to exclude consumer sales from the sphere of the application of the Convention. Article 2 provides

> "This Convention does not apply to sales... of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the

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[18] Section 2301(6) of the Magnuson-Moss Warranty Act provides:
"The term "written Warranty" means—
(A) any written affirmation of fact or written promise made in connection with the sale of a consumer product by a supplier to a buyer which relates to the nature of the material or workmanship is defect free or will meet a specified level of performance over a specified period of time, or
(B) any undertaking in writing in connection with the sale by a supplier of a consumer product to refund, repair, replace, or take other remedial action with respect to such product in the event that such product fails to meet the specifications set forth in the undertaking,
which written affirmation, promise or undertaking becomes part of the basis of the bargain between a supplier and a buyer for purposes other than resale of such product."

[19] Infra, p.198.

[20] Section 2301(6) of the Magnuson-Moss Warranty Act, supra n.18.

[21] Infra, p.248.

contract, neither knew nor ought to have known that the goods were bought for any such use".

Under this Article, consumer sales are excluded from the sphere of the application of the Convention. This is due to the different types of consumer protection among the signatory countries.[22] Clearly, in cases of consumer goods, the seller will be expected to know that the goods are intended to be put for "personal, family or household use"[23]. Here, it would be hard for the seller to prove that he did not know or it was not reasonable for him to know, at the time of making the contract, that the goods were purchased for "personal, family or household use".[24] However, where the goods are designed to be used by a commercial buyer or the quantity of the goods indicate that the goods are purchased for commercial use,[25] the Convention will apply unless the seller had a reason to know that the goods were purchased for personal use.[26] Likewise, if the buyer is an agent for a company, the seller may not be expected to know that the goods are bought for personal use.

In view of this, the fact that the goods are designed for consumer use does have a direct effect on the applicability of the Convention. What matters here is the awareness of the seller of the purpose of purchase at the time of making the contract. Importantly, the awareness of the seller after the time of making the contract is irrelevant for the purpose of determining the applicability of the Convention. Therefore, in cases of goods used for commercial use, the Convention will apply regardless of the fact that the seller found that the goods were purchased for consumer use after the time of making the contract.[27]

It is unclear whether Article 2 of the Convention applies to the issue of whether the buyer or the seller is required to show evidence of the purpose of purchase. The point is controversial. Whereas some legal writers support the view that proof is a procedural

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[22] Comment 3 to Article 2, prepared by the Secretariat of the United Nations.
[23] Family use does not only include blood relatives and those related by marriage. The interpretation of "family use" must not be affected by domestic laws. Such an interpretation must be towards sociological rather than legal criteria. For example, the family use may include the purchase of a gift for a god-child. See here Peter Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods (CISG),* translated by Geoffrey Thomas, Oxford, 2nd ed., 1998, p.32.
[24] See John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention,* 2nd ed., 1991, p.97.
[25] Commercial use includes professional use such as office equipment bought by a doctor.
[26] Comment 4 to Article 2, prepared by the Secretariat of the United Nations.
[27] F. Enderlein and Dietrich Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods,* New York, 1992, P.33.

matter which is left to domestic law,[28] others support the view that Article two applies to the issue of proof.[29] Professor Ferrari, after supporting the view that Article 2 applies to the issue of proof, suggests that the burden of proof is not always placed on the seller since the buyer might be interested in the application of the Convention.[30]

Of course, the CISG does not deal with the type of evidence which should be accepted by the court. However, where the seller shows a sufficient proof that he was neither aware nor ought to be aware, at the time of making the contract, that the goods were bought for consumer use, Article 2 should be applied to allow the application of the Convention. It should be noted that the buyer may be interested in the application of the Convention where the domestic consumer protection law offers less right than the Convention.[31] If this becomes the case, the buyer may need to show that the seller could not have reasonably been aware, at the time of making the contract, that the goods were bought for consumer use. In cases where the buyer is not interested in the application of the Convention, he should prove that the seller was or ought to have been aware, at the time of making the contract, that the goods were purchased for personal use.

Nevertheless, determining the applicability of the Convention under Articles 1 and 2 of the Convention[32] may not be necessary in cases of certain loss. The applicability of the Convention is excluded, by its own provisions, in certain cases such as the case of personal injury as discussed in chapter five.[33]

2.3 Definition of the Concept of Compensatory Damages

Generally, damages "are the pecuniary recompense given by process of law to a person for the actionable wrong that another has done him."[34] Damages for breach of contract can be defined as an amount of money obtained by success in action for breach of contract.[35]

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[28] Khoo in Bianca and Bonell, *Commentary on the International Sales Law,* Mailand, 1987, p.39.
[29] Peter Schlechtriem, supra n.23 at p.33. See Franco Ferrari, 'Specific Topics of the CISG in the Light of Judicial Application and Scholarly Writing' (1995) 15 *J. L. & Com.* 1; available at <http://cisgw3.law.pace.edu/cisg/biblio/2ferrari.html> text accompanying nn.496-499.
[30] Franco Ferrari, ibid, text accompanying note 502.
[31] Peter Schlechtriem, supra n.23 at p.33.
[32] See Article 1 supra p.20; Article 2 supra p.22.
[33] Infra, p.172.
[34] Halsbury's Laws of England, 4th ed. Reissue, Vol. 12(1), para.802.
[35] Harvey McGregor, *McGregor on Damages*, London, 16th ed., 1997, p.3.

Compensatory damages are those damages which are awarded to recompense an actual loss or injury sustained.[36] In cases of breach of warranty of quality, the term "compensatory damages" refers to those damages which are awarded to recompense an actual loss or injury resulting from the defective quality of goods.

Non-compensatory damages such as liquidated damages, nominal damages and exemplary damages, are clearly excluded from the aforementioned definition of compensatory damages. Liquidated damages are the certain sum of money stipulated by the parties to be payable on breach. Such a sum of money may be more or less than the compensation for the loss suffered by the buyer.[37] As for nominal damages, the buyer may be allowed such damages in cases where he fails to prove that he has suffered damage caused by the seller's breach, provided that such a breach is sufficiently proved or indisputable.[38] Exemplary damages[39] are the award which is intended to punish the wrongdoer and not to compensate the aggrieved party. Exemplary damages are not available in contract law. Clearly, the examination of non-compensatory damages is not within the scope of this work.

Defective quality may be considered as a breach of condition which entitles the buyer to reject the goods and claim damages for nondelivery.[40] Under the SGA, where the buyer accepts defective goods, subject to his claim for damages, he will not be able to revoke his acceptance. Unlike the SGA, the UCC allows the buyer in certain cases to revoke his acceptance and return the defective goods. Where the defect 'substantially impairs' the value of the goods and the seller could not reasonably discover the defect before

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[36] *Livingstone v. The Rawyards Coal Company* (1880) 5 AC 25, 39.
[37] S.M. Waddams, *The Law of Damages,* Toronto, 1983, p.521.
[38] In *Mediana v. Comet, (The Mediana)* [1900] AC 113, Lord Halsbury, L.C., pointed out, at p.116, that "'Nominal damages' is a technical phrase which means that you have negatived anything like real damages, but that you are affirming by your nominal damages that there is an infraction of a legal right which, though it gives you no right to any real damages at all, yet gives you a right to the verdict or judgment because your legal right has been infringed."
[39] The term "punitive damages" is recommended by the Law Commission to be used instead of "exemplary damages". Law Commission, *Aggravated, Exemplary and Restitutionary Damages,* Law Com No 247, para.5.31.
[40] This is subject to Section 15A of the SGA which does not entitle the buyer to reject defective goods in cases where the defect is simple. Deciding whether the defect is simple is a matter of fact which depends on the circumstances of each case. Furthermore, the seller will not be liable for defects which are drawn to the buyer's attention before the conclusion of the contract. Section 14(2C) of the SGA states "The term implied by subsection (2) above [satisfactory quality] does not extend to any matter making the quality of goods unsatisfactory— (a) which is specifically drawn to the buyer's attention before the contract is made, (b) where the buyer examines the goods before the contract is made, which that examination ought to reveal, or (c) in the case of a contract for sale by sample, which would have been apparent on a reasonable examination of the sample."

acceptance or his acceptance was induced by the seller's assurances, the buyer may revoke his acceptance under Section 2-608 of the UCC. Moreover, Section 2-608 allows the buyer to revoke his acceptance in cases where the defect 'substantially impairs' the value of the goods and the buyer accepts the defective goods on the reasonable assumption that the defect "would be cured and it has not been seasonably cured".[41] Nevertheless, where the buyer retains defective goods, he may be entitled to damages for breach of warranty of quality. This work is concerned with the buyer's remedy of damages where the buyer does not revoke his acceptance of the goods in question.

As regards the CISG, damages do not seem the primary remedy under the Convention. In cases where the seller delivers nonconforming goods, the buyer may have the choice to claim damages or specific performance. Under Article 46 of the CISG, the buyer may require delivery of substitute goods "if the lack of conformity constitutes a fundamental breach of contract".[42] Where the goods do not conform with the contract, the buyer may require the seller to remedy the lack of conformity by repair.[43]

Where the buyer has made a bad bargain, he may reject the defective goods in order to avoid his market loss. A simple hypothetical example may clarify this point. Suppose that the contract price is £1000. Suppose further that at the time of delivery the market price of the goods as warranted is £900 and the market price of the defective goods is £600. In this example, the buyer has made a bad bargain. If the buyer rejects the goods,

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[41] Section 2-608 of the UCC states

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

[42] Article 46 of the CISG states:

"(1) The buyer may require performance by the seller of his obligations unless the buyer has resorted to a remedy which is inconsistent with this requirement. (2) If the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach of contract and a request for substitute goods is made either in conjunction with notice given under article 39 or within a reasonable time thereafter."

[43] Article 46(3) of the CISG states "If the goods do not conform with the contract, the buyer may require the seller to remedy the lack of conformity by repair, unless this is unreasonable having regard to all the circumstances. A request for repair must be made either in conjunction with notice given under Article 39 or within a reasonable time thereafter." Furthermore, Article 49 of the CISG allows the buyer to avoid the contract in cases where the defect of the goods amounts to a 'fundamental breach'. See infra p.44.

he will be entitled to damages for non-delivery i.e. the difference between the market price and the contract price.[44] Since the contract price is higher than the market price, the buyer will not be entitled to more than nominal damages. However, by rejecting the defective goods, the buyer can avoid his obligation to pay the price and can obtain substitute goods for £900. By this way, the buyer will save £100 (£1000 [The contract price] - £900 [The substitute goods price]). On the other hand, if the buyer chooses to accept the goods, he will be entitled to damages for breach of warranty i.e. the difference between the value of the goods as defective and the value they would have had if they had been free from defects. In this hypothetical example, if the goods are valued under the market price, the buyer will be entitled to recover £300 (£900 [The market price of the goods as warranted] - £600 [The market price of the goods as accepted]). By accepting the goods, the buyer will lose £100 which is the difference between the contract price (£1000) and what he has obtained (£900 [£600 the value of the defective goods + £300 the recovered damages]). In such a case, it is likely that the buyer will reject the goods.[45]

However, in cases of latent defect, the buyer may not be able to discover the defect before acceptance. Under the UCC, the buyer may be entitled to revoke his acceptance, as explained above.[46] Where the buyer cannot, or chooses not to, revoke his acceptance, he will be entitled to recover, as damages, the difference between the value of the goods as warranted and their value as defective. Moreover, in certain cases, the buyer may prefer to accept defective goods. This may be the case where there is no available market to obtain substitute or where the goods in question are of subjective value for the buyer, as discussed in chapter three.[47] In addition, where the goods are of less productive capacity than the capacity specified in the contract, the buyer may accept the goods in order to perform subcontracts and keep his commercial reputation.[48] In such a case, the buyer may be entitled to damages for loss of profit resulting from the deficient capacity of the goods, as explained in chapter four.[49]

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[44] Sections 51 of the SGA, 2-713 of the UCC and Article 76 of the CISG.
[45] See Ellen A. Peters, 'Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two' (1963) 73 *The Yale Law Journal* 199, 270.
[46] Supra, p.25.
[47] Infra, p.55.
[48] This is the case of profit-making goods where the substitute cannot be immediately obtained from the open market.
[49] Infra, p.129.

2.4 Types of Loss resulting from Breach of Warranty of Quality

Losses resulting from breach of warranty of quality can be classified as normal and consequential as stated in the previous chapter.[50] The UCC adds another kind of loss, i.e. incidental damages[51](incidental loss).[52] The term incidental losses neither exists under the SGA nor the CISG. Although Professor Treitel[53] classifies losses, resulting from breach of contract, as normal, consequential and incidental, it is hard to find such a classification in any case report. Anyhow, losses that can be classified as incidental can only result in cases of non-acceptance. Section 2-715(1) of the UCC states

> "Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach."

As consequential losses are incidental of the breach and incidental losses are consequential for the breach, one may find it difficult to draw a distinction between the two kinds of loss. However, the examples provided in Section 2-715(1) indicate that incidental losses are mostly the expenses incurred in obtaining substitute goods and handling the rejected goods in cases of non-acceptance. It seems that incidental losses are always incurred within the scope of the immediate buyer-seller transaction where there is a cover and the buyer rejects the goods or revokes his acceptance.[54] On the other hand, consequential losses are those incurred by the buyer, as a result of the breach, in his relation with a third party, to his business or to any physical interest such as personal injury.[55] In *Petroleo Brasileiro, S.A., Petrobras v. Ameropan Oil Corp*.[56] it was made clear that "[w]hile the distinction between the two [incidental and consequential damages] is not an obvious one, the Code [UCC] makes plain that incidental damages are normally incurred when a buyer (or seller) repudiates the contract or wrongfully

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[50] Supra, p.5.

[51] The term damage can be used to mean a harm; however, its plural "damages" is normally used to mean the money compensation. In this view, the term loss is more desirable to be used to avoid any possible confusion.

[52] For the purpose of this work, incidental damages will be referred to as incidental losses.

[53] Sir Guenter Treitel, *The Law of Contract,* London, 10th ed., 1999, p.879.

[54] Comment 1 to Section 2-715 of the UCC provides "[Section 2-715(1)] is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully *rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover* where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely illustrative of the typical kinds of the incidental damage." [Emphasis added] See Special Project, 'Article Two Warranties in Commercial Transactions' (1978) 64 *Cornell L. Rev.* 30, 132.

[55] *Sprague v. Sumitomo Forestry Co.* 104 Wn.2d 751, 762 (1985).

[56] 372 F. Supp. 503 (E.D.N.Y. 1974).

rejects the goods, causing the other to incur such expenses as transporting, storing or reselling the goods. On the other hand, consequential damages do not arise within the scope of the immediate buyer-seller transaction, but rather stem from losses incurred by the non-breaching party in its dealings, often with third parties, which were a proximate result of the breach, and which were reasonably foreseeable by the breaching party."[57] Therefore, losses resulting from breach of warranty of quality, other than the diminution in value of the goods supplied, should always be dealt with as consequential. However, in two American cases, at least, the extra expenses incurred to run defective machinery were considered incidental losses.[58]

Here, it is worth noting that the normal restrictions imposed on the recovery of damages, i.e. causation, remoteness, mitigation and certainty, do not apply under the UCC to cases of incidental losses.[59] However, it should be clear that incidental losses, by their nature comply with such restrictions.[60] As regards exclusion clauses, the question here is what would be the case if exclusion clauses of incidental loss were of a contract governed by the SGA or the CISG? In the light of the fact that the term incidental loss does not exist under the SGA and the CISG, it seems hard to state a clear-cut answer to this question. Probably, the court will examine the circumstances of each case in order to find out the actual meaning of the term which is intended by the parties. Nonetheless, it should be

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[57] *Petroleo Brasileiro, S.A., Petrobras v. Ameropan Oil Corp.* 372 F. Supp. 503, 508 (E.D.N.Y. 1974).

[58] In *Lewis v. Mobile Oil Corp.* 438 F.2d 500, 8 UCC Rep. Serv. 625 (8th Cir. 1971) where the seller supplied oil to the buyer's sawmill system which appeared unsuitable, the buyer was awarded damages for the expenses incurred on the excessive quantities of oil used to run the system and the repair and replacement of mechanical parts damaged by the failure of the oil to function as warranted. In this case, the United States Court of Appeals for the Eighth Circuit considered the incurred expenses as incidental loss. In fact the buyer in this case did not reject the goods nor did he revoke his acceptance and there was no cover. Nevertheless, the Court dealt with the loss of expenses as incidental loss. The decision in *Lewis* was followed in *General Supply & Equip. Co. v.Phillips,* 490 S.W.2d 913, 12 UCC Rep 35 (Tex. Ct. App. 1972). See J.J. White, R.S. Summers, *Uniform Commercial Code,* West Publishing Co., 4th ed., 1995, p.370.

[59] For the restrictions imposed on the recovery of damages, see infra, p.277.

[60] In relation to the restrictions imposed on the recovery of damages, Section 2-715(1) makes it plain that the recoverable incidental losses should be reasonable. The Section does not apply the normal restrictions imposed on the recovery of damages, i.e. causation, remoteness, certainty and mitigation. Here, one may note that incidental losses, by their nature, comply with the restrictions imposed on the recovery for consequential losses. Needless to say that such expenses are normally certain as to their amount. As for the remoteness principle, such expenses cannot be remote since parties to a sale of goods contract normally contemplate, at the time of making the contract, that such expenses are not unlikely to be incurred as a result of the breach. Furthermore, avoidable incidental expenses incurred by the buyer are normally unreasonable and, as a result, not recoverable under Section 2-715(1) of the UCC. It seems that the object of the drafters of the UCC, in not applying the restrictions mentioned to the recovery for incidental losses, is to avoid the unnecessary requirement of proof; the buyer, in cases of incidental loss, need not prove the compliance of the loss with the restrictions mentioned.

clear that losses resulting from breach of warranty of quality cannot be classified as incidental. Such losses should always be dealt with as normal or consequential losses.[61]

2.5 Other Compensatory Damages Claimed in Cases of Retained Defective Goods

Damages for diminution in value and consequential losses may not be the only compensatory damages recoverable in cases of defective quality. The following will deal with another kind of compensatory damages, i.e. damages for loss of the right to reject, which may be claimed in certain cases of international sale of goods. This kind of damages has been developed by the English courts and as yet, does not have any statutory basis.

2.5.1 What is "Loss of the Right to Reject"?

In the field of international sale of goods, the buyer may be required to pay the price against conforming documents. One of these documents can be quality certificate which deals with certain aspects of the quality of goods. The requirement of quality certificate is quite common in certain sales, such as sale of oil. Under certain contracts, if the quality certificate is in conformity with the contract, the buyer will be required to pay the contract price against the certificate, provided that the rest of the required documents are in conformity with the contract. The bill of lading is usually part of the documentary bundle against which the buyer pays the price. The bill of lading contains a description of the goods as to the quality.[62] The cases discussed below are mostly concerned with the date of shipment which is part of the description of the goods.[63] In such cases, the discussion is concerned with the conformity as to the actual date of shipment and as to the documents which state the date of shipment. Obviously, the same applies to the

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[61] Although Article 74 of the CISG does not recognize the distinction between consequential and incidental losses, the American court in one case has allowed damages for foreseeable incidental losses. In fact, Article 74 of the Convention applies the restriction of remoteness to the recovery for all kinds of loss. In the CISG case of *Delchi Carrier, SpA v. Rotorex Corp.*, 71 F.3d 1024 (2d Cir. 1995) the United States Court of Appeals for Second Circuit made it clear that the buyer's claim for incidental losses can be successful where such losses are foreseeable. In this case, the Court applied the restriction of remoteness to the recovery for incidental losses although, under the UCC, such a restriction applies only to the recovery for consequential losses. See E.C. Schneider, 'Consequential Damages in the International Sale of Goods: Analysis of Two Decisions' (1995) 16 *U. Pa. J Int'l Bus. L.* 615, 628; E.C. Schneider, 'Measuring Damages under the CISG: Article 74 of the United Nations Convention on Contracts for the International Sale of Goods' 9 *Pace Int'l L. Rev.* 223, n.33.

[62] See Clive M. Schmitthoff, *Schmitthoff's Export Trade: the Law and Practice of International Trade*, London, 9th ed., 1990, p.584; John F Wilson, *Carriage of Goods by Sea,* London, 3rd ed., 1998, p.126.

[63] *Kwei Tek Chao v. British Traders and Shippers, Ltd.* [1954] 2 QB 459, 472. See also *Bowes v. Shand* (1877) 2 AC 455 discussed in A.G. Guest, supra n.4 at para.18-207.

conformity as to the quality of goods and as to the documents which are concerned with such a quality.

Under the CIF contract[64] the seller has two separate obligations, i.e. to deliver documents and to ship goods in conformity with the contract. Under this kind of contract the buyer must also pay the price against conforming documents. If the buyer refuses to pay the price, he may be in breach of contract which allows the seller to rescind the contract and claim damages for non-acceptance. However, where such documents are not in conformity with the contract, the buyer will have the right to reject them. In fact, the CIF contract requires the buyer to pay the price against conforming documents even though the goods are not in conformity with the contract. This was decided by the House of Lords in *Gill & Duffus S.A. v. Berger & Co. Inc.*[65] In this case, Lord Diplock disapproved[66] of the view, stated by Robert Goff LJ at the Court of Appeal,[67] that the buyer can reject conforming documents where he can prove that the defect of the goods entitles him to reject such goods. In *Gill & Duffus*, the buyers refused to pay the price against conforming documents on the grounds that the goods allegedly were not in conformity with the contract. The sellers rescinded the contract and claimed damages for non-acceptance. The House of Lords held the buyers liable. Lord Diplock's view is that the CIF buyer has to pay against conforming documents even though the goods are defective. In *Gill & Duffus,* the documents that were required for paying the price were not concerned with the quality of the goods. In such a case, the buyer has to pay against such documents even though the goods are not of the right quality. In *Gill & Duffus,* Lord Diplock stated a number of exceptions to his view. First, the buyer will be entitled to reject such documents where the seller is guilty of fraud.[68] Secondly, the buyer may be entitled to reject conforming documents in cases where the goods are fundamentally different from those which had been sold.[69]

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[64] For the CIF contract, see Schmitthoff, supra n.62 at p.33; Michael Bridge, supra n.9 at p.156; A.G. Guest, supra n.4 at p.1247.
[65] [1984] AC 382.
[66] Ibid at p.396.
[67] [1983] 1 Lloyd's Rep. 622, 635.
[68] *Gill & Duffus S.A. v. Berger & Co. Inc.,* [1984] AC 382, 390.
[69] It should be clear that where the documents show that the shipped goods are fundamentally different from those sold, the buyer may reject such documents on the ground that the documents are not genuine since they wrongly describe the goods sold. *Gill & Duffus S.A. v. Berger & Co. Inc.,* [1984] AC 382, 390. See G. H. Treitel, 'Rights of rejection under CIF sales' [1984] *LMCLQ* 565, 576-7. F.M.B. Reynolds, 'Rejection of Documents' [1984] *LMCLQ* 191, 193.

Nevertheless, the seller may deliver apparently conforming documents which, in breach of contract, show the goods free from defects although the goods are actually defective. Both the CIF seller and buyer may not be aware of the defect of the documents at the time when the buyer accepts them and pays the price. In such a case, the market price of goods may fall between the time of making the contract and the time of delivery of goods. If the documents revealed *on their face* the defect of the goods, which could justify the rejection of such goods,[70] the buyer could have rejected the documents and, as a result, avoided his market loss.[71] By rejecting the documents, the buyer would throw his market loss back on the seller.[72] However, by accepting the documents, the buyer has lost his right to reject them. In such a case, is the buyer entitled to damages for his market loss that could have been avoided by rejecting the documents?

2.5.2 Recoverability of Damages for Loss of the Right to Reject

In order to achieve the objective of damages, as stated in *Robinson v. Harman,*[73] in cases of loss of the right to reject, the buyer should be put in the same financial position he would have been in if the buyer had exercised his right to reject the documents. It is well settled that the seller must be in double breach, i.e. non-conforming goods and non-conforming documents, in order to allow the buyer damages for loss of the right to reject. This was made clear in *James Finlay & Co. Ltd. v. N. V. Kwik Hoo Tong Handel Maatschappij*[74] where the seller received payment against documents which wrongly stated the date of shipment. In this case, the seller delivered defective goods since they were not shipped within the shipment period stated in the contract. The seller received the price against such documents since they were *apparently* conforming. In this case, there was a sharp fall in the market price of the goods between the time of making the contract and the time of delivery of goods. The Court awarded the buyer damages for this market loss on the ground that the buyer could have rejected the documents and avoided such a loss if it had been clear from the documents that the goods were not in conformity with the contract.

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[70] A.G. Guest, supra n.4 at p.1347.
[71] *Vargas Pena Apezteguia Y Cia Saic v. Peter Cremer G.M.B.H.* [1987] 1 Lloyd's Rep. 394.
[72] G.H. Treitel, 'Damages for Breach of a c.i.f. Contract' [1988] *LMCLQ* 457.
[73] (1848) 1 Exch 850, 855. Supra, p.1.
[74] [1928] 2 KB 604. In this case the sellers shipped the goods in question on the 1st of October even though it was agreed that the shipment should be made in September. The sellers tendered bills of lading which falsely stated that the goods had been shipped on 30th of September. The buyers discovered this breach after two years from the time of delivery.

Therefore, where the goods are not in conformity with the contract and the seller receives payment against conforming documents, the buyer will not be entitled to recover damages for his market loss. This was the case in *Taylor v. Bank of Athens,*[75] where goods were shipped after the stipulated period of shipment. However, the seller received payment against delivery order which did not contain a false date of shipment. The seller, acting in good faith, assured the buyer that the bills of lading were dated 31st of August. The seller did not know that the bills of lading were falsely dated. The Court did not allow damages for market loss on the ground that the seller received payment against conforming documents.[76] In this case, the seller was entitled under the contract to receive payment against delivery order. It has been suggested that the decision in *Taylor* would have been different if the seller had paid the price against the falsely dated bills of lading.[77]

In addition, the buyer will not be entitled to damages for loss of the right to reject where the documents are nonconforming and the goods are in conformity with the contract. This has been decided in *Procter & Gamble Philippine Manufacturing Corp. v. Kurt A. Becher.*[78] In this case, the seller received payment against documents which falsely stated the date of shipment.[79] However, the goods were shipped within the stipulated

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[75] [1922] 27 Com Cas 142. In this case, the shipment was stipulated to be in August. The seller shipped the goods in September. There was a fall in the market price between the time of making the contract and the time of delivery of goods. There was no difference in the market price of the goods between 31st of August and the actual date of shipment. Therefore, the buyer was not entitled to damages for breach of warranty since there was no loss caused by the delay in shipment. Neither was the buyer allowed damages for market loss since the Court did not find the delivery order a defective document. Consequently the Court held that the buyer is not entitled to more than nominal damages.

[76] If the seller was guilty of fraud, the decision might be different. This can be justified on the grounds that the seller should not benefit from the normal rule of loss of the right to reject if he was able to tender conforming documents and he was aware at the same time that the goods were not in conformity with the contract. See G. H. Treitel, supra n.69 at p.576.

[77] A. G. Guest, supra n.4 at p.1386.

[78] [1988] 2 Lloyd's Rep. 21. In this case, the seller received 98 per cent of the price against a misdated bill of lading. Shipment was agreed to be made by the end of January but later the parties agreed to extend the period of shipment until the end of February. The bill of lading was dated January 31 although the shipment was not made until the end of February. By the time of delivery of goods, the buyer discovered that he had paid against defective documents. Due to this, he claimed damages for his market loss. The Court held that the buyer was not entitled to such damages. In this case, there was a single breach, i.e. defective documents. The goods were shipped within the stipulated period of shipment.

[79] Where the seller tenders defective documents before the end of the stipulated period of delivery, he may be entitle to replace such documents with conforming documents within the period of delivery. See A. G. Guest, supra n.4 at p.1296. Similar rule can be found under the UCC and the CISG. Section 2-508(1) of the UCC states "Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery." Article 34 of the CISG states "If the seller is bound to hand over documents relating to the goods, he must hand them over at the time and

period. The buyer was not allowed damages for his market loss. The decision, in this case, can simply be explained on the grounds that the purpose of such damages is to put the buyer in the same financial position he would have been in if the documents had not been defective. In *Procter & Gamble*, if the bill of lading had been rightly dated, the buyer would not have been able to reject it. Therefore, the market loss, which the buyer suffered, is not due to the seller's breach of tendering defective documents. "What the buyers lost, in the event, was the opportunity to exercise one of the remedies (rejection) afforded by the law in respect of the breach [of tendering conforming documents]. They lost the opportunity to exercise that remedy, not because of the breach... but because they did not know of the existence of the breach at the time. But... having lost the opportunity to exercise the remedy of rejection in respect of the breach, thenceforth the buyers' remedy in respect of the breach was confined to recovering the actual financial loss, if any, suffered by them by reason of the breach..."[80] In this case, the Court found that the buyers suffered no loss due to the seller's breach of tendering non-conforming documents.

2.5.3 Issues Concerning the Recoverability of Damages for Loss of the Right to Reject

The first question, which seems to have a straightforward answer under the common law, is whether the recovery of damages for market loss is available only in cases where the seller is guilty of fraud in delivering the defective documents which appear, *on their face,* in conformity with the contract. The answer to this question is clear-cut under the common law. The buyer need not prove the seller's fraudulent behaviour in delivering the documents. Neither does he need to show that the seller was aware of the fraudulent behaviour of somebody else for whom the seller is responsible. This can be understood from the case of *James Finlay.*

However, one may ask whether the seller's fraudulent behaviour, or his awareness of the fraudulent behaviour of somebody for whom he was responsible, in delivering the defective documents should be a prerequisite for the recovery of damages for market

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place and in the form required by the contract. If the seller has handed over documents before that time, he may, up to that time, cure any lack of conformity in the documents, if the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. However, the buyer retains any right to claim damages as provided for in this Convention."

[80] *Procter & Gamble Philippine Manufacturing Corp. v. Kurt A. Becher,* [1988] 2 Lloyd's Rep. 21, 32 per Nicholls LJ.

loss? In fact, legal writers seem to disagree on this matter. Professor Treitel suggests that the recovery of damages for loss of the right to reject should be "available only where the seller (or someone for whom he was responsible) was to blame for the false documents, or at least knew of their falsity at the time of tender of documents."[81] This opinion responds to the view of Donaldson J. in *The Kastellon.*[82] In this case, Donaldson J awarded the buyers damages for their loss of the right of rejection "[w]ith some regret, because their [was] little merit in the buyers' contention".[83] In this case, the goods were shipped out of the stipulated period of shipment. The buyers paid against falsely dated bills of lading. It became clear to them after they accepted the goods that the bills of lading were defective. It seems that Donaldson J expressed his regret due to that fact that the goods arrived in the expected time. There was no delay in their arrival. However, as Professor Bridge suggests,[84] the decision in this case is consistent with the common law position regarding the rules of termination in normal sale transactions where the buyer pays against delivery. The common law position is that the buyer need not prove that he has suffered actual loss in order to reject defective goods. The actual purpose of the buyer is irrelevant as long as there is a sufficient ground of termination. Indeed, the buyer may reject defective goods in cases where his real intention is to avoid his market loss. Therefore, in cases where the buyer pays against documents, he may reject the documents if they reveal *on their face* the defect of the goods regardless of his actual intention of the rejection. If the buyer finds out after he has accepted the goods that he lost his right to reject the documents, it will be fair enough to award him damages in order to be put in the same financial position he would have been in had he rejected the documents.

Another significant question here is whether the buyer is entitled to damages for his market loss in cases where he became aware of the non-conformity of the documents by the time of the delivery of goods? The answer to this question can be found in *Kwei Tek Chao v. British Traders Ltd.*[85] In this case, the goods were shipped after the stipulated period of shipment. The buyer paid the price against bills of lading which showed *on their face* that the goods were shipped within the stipulated period. The buyer became aware of the actual date of shipment before receiving the goods in question. In other

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[81] This was stated by Sir Guenter Treitel in A. G. Guest, supra n.4 at p.1393.
[82] *Huilerie L'Abeille v. Societe Des Huileries Du Niger (The "Kastellon")* [1978] 2 QB 203.
[83] Ibid at p.207.
[84] See Michael Bridge, supra n.9 at p.369.

words, the buyer had the chance to reject the goods and, consequently, avoid his market loss. However, the buyer accepted the goods and sued *successfully* for his market loss.

However, in *Kwei Tek Chao*, although the Court achieved the objective of damages, as stated in *Robinson v. Harman,*[86] by putting the buyer in the same position he would have been in had the breach never happened, it is doubtful that the market loss was caused by the buyer's loss of his right to reject the defective documents. The Court should always look at the actual losses caused by the seller's breach before applying the principle of *Robinson.* In fact, the buyer's loss resulted from his acceptance of the goods. The buyer had the right to reject the goods and did not exercize it. The buyer could have avoided his market loss by rejecting the goods. He could have brought a restitutionary action to recover the price had he rejected the goods. Therefore, as Professor Bridge suggests,[87] the causal link between the seller's breach and the buyer's loss in *Kwei Tek Chao* seems to be broken. In *James Finlay,*[88] the seller's act of delivering defective documents concealed the buyer's right to reject the goods. Such a concealment did not exist in *Kwei Tek Chao.* It is understandable that, in the normal course of circumstances, the rule of *Kwei Tek Chao* may not operate against the seller. Where the buyer rejects the defective goods, the seller may not be in a better financial position as compared to the case where the buyer retains the defective goods and recovers, as damages, his market loss.[89] However, this cannot be a justification for awarding the buyer damages for his market loss in cases where such a loss is caused by his choice to accept the goods. It is submitted that the buyer in *Kwei Tek Chao* was overcompensated by entitling him to damages for his market loss which was not caused by the seller's breach.

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[85] [1954] 2 QB 459.
[86] (1848) 1 Exch 850, 855. Supra, p.1.
[87] Michael Bridge, supra n.9 at p.365.
[88] *James Finlay & Co. Ltd. v. N. V. Kwik Hoo Tong Handel Maatschappij* [1928] 2 KB 604.
[89] In *Kwei Tek Chao v. British Traders and Shippers, Ltd.* [1954] 2 QB 459, Devlin J. said, at p.483, that "[i]n fact, if [the buyer] had rejected the goods it would not have been to the advantage of the seller in any way nor would it have minimized the damages. The damages would have been just the same except that the seller would, no doubt, have had the convenience of handling the goods instead of the buyer." For example, suppose that the contract price is £1000 and the market price at the time of delivery of goods is £700. Suppose further that there is no diminution in value of the goods due to there defect. The market loss in such a case is £300 (£1000-£700). If the buyer rejects the goods, he will be entitled to recover the contract price (£1000). The buyer will be in the same financial position if he retains the defective goods (£700) and recovers damages for his market loss (£300).

The Court in *Kwei Tek Chao* relied on the ground that the buyer could not, as a matter of business, reject the goods.[90] The Court justified its award on the ground that it is unreasonable to expect the buyer, after he has paid the price on tender of documents, to reject the goods which constitute his only security for his claim against the seller.[91] However, this ground, i.e. to rely on the *business* reasons of the buyer for not rejecting the goods, seems with many respects to be doubtful. The reasoning of *Kwei Tek Chao* can apply to any transaction where the buyer pays the price by the time of delivery of goods. Where the seller delivers defective goods and the buyer paid the price by the time of delivery, the latter may rely on the reasoning in *Kwei Tek Chao* to accept the goods and sue for his market loss although there is single breach, i.e. defective goods. Here, it should be noted that the case of *Kwei Tek Chao* was approved by the House of Lords in *Gill & Duffus S.A. v. Berger & Co. Inc.*[92]

The rule of *Kwei Tek Chao* seems to be helpful where the buyer pays against *apparently* conforming documents and cannot *as a matter of law* reject defective goods. This point should be considered in conjunction with the rule of *Procter & Gamble Philippine Manufacturing Corp. v. Kurt A. Becher.*[93] The question under this rule can be whether the buyer would have had the right to reject the documents if they had revealed the defect of the goods, which did not justify the rejection of such goods. The answer to this question depends on whether or not the documents, by revealing the defect of the goods, could be rendered defective. In certain cases, the documents which reveal the defect of the goods may not be described as defective.[94] This was the case in *Vargas Pena Apezteguia Y Cia Saic v. Peter Cremer G.M.B.H.*[95] In this case, the seller tendered a

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[90] *Kwei Tek Chao v. British Traders and Shippers, Ltd.* [1954] 2 QB 459, 482.
[91] A.G. Guest, supra n.4 at p.1388.
[92] [1984] AC 382, 395.
[93] [1988] 2 Lloyd's Rep. 21. See supra, p.33.
[94] Michael Bridge, supra n.9 at p.367.
[95] [1987] 1 Lloyd's Rep. 394. The case was of FOB contract but most of the authorities mentioned in the judgment concern CIF contracts. In this case the sellers sold 1500 tonnes of cottonseed. The contract contained a term "Max. 15% fat. If above 15% rejectable at buyers' option..." The sellers tendered documents which showed on their face that the percentage of fat exceeded 15%. The buyers resold the goods in question in order to mitigate their loss. The Court found that the buyers did not reject the goods. The act of resale showed that buyers accepted the goods since such an act was inconsistent with the sellers' ownership. In this case, there was a fall in the market between the time of contracting and the time of resale. The Court held that the loss suffered by the buyers, i.e. the difference between the contract price and the resale price, was not caused by the sellers' breach. It was due to the fall in the market which was not avoided by the buyer who could have done so by rejecting the documents. The Court held that the buyers were entitled to no more than nominal damages. The buyers could have avoided their loss resulting from the fall in the market if they had rejected the documents. It is noteworthy that the documents in this case were not defective since they revealed the right quality of the goods. However, the Court held that the

pre-analysis certificate which revealed *on its face* that the goods were not in conformity with the contract. The pre-analysis certificate in this case cannot be as described defective since it stated correctly the quality of the goods. However, in reliance on the discussion in *Vargas Pena,* one may note that where the documents reveal *on their face* the defect of the goods, which justifies the rejection of such goods, the buyer may reject the documents and bring the contract to an end. Therefore, if the buyer, after accepting the goods, discovers that he has paid against documents that did not reveal the defect of the goods, *which justifies the rejection of such goods,* he may be entitled to damages for his market loss. In such a case, the rule of *Procter & Gamble* will not restrict the buyer's recovery. If the documents had revealed the defect of the goods, which justifies the rejection of such goods, the buyer could have rejected the documents and avoided his market loss. Therefore, it can be said, in such a case, that the buyer lost his right to reject and, thus, he is entitled to damages for his market loss. However, it should be noted that if the buyer discovered that the goods are defective after he had accepted the documents and before accepting the goods, he should not be entitled to damages for his market loss. As the buyer did not lose his right to reject the goods, he can avoid his market loss by rejecting the goods.

Nonetheless, in certain circumstances the defect of the goods may not justify their rejection. For example, under Section 15A(1) of the SGA, the buyer is not entitled to reject defective goods where the defect is so slight that it would be unreasonable for the him to reject such goods.[96] Furthermore, the buyer may not be entitled to reject defective goods where the breach is of an intermediate term. Here, if the buyer has paid against documents that do not reveal the defect in the goods, *which does not justify the rejection of such goods*, can he be entitled to damages for his market loss? At first sight, one may answer this question in the negative under the rule of *Procter & Gamble* for the reason that if the documents had revealed the defect of the goods, *which does not justify the*

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buyers could have rejected the documents on the grounds that they revealed *on their face* that the goods were defective.

[96] Section 15A(1) of the SGA states: "Where in the case of a contract of sale— (a) the buyer would, apart from this subsection, have the right to reject goods by reason of a breach on the part of the seller of a term implied by section 13, 14 or 15 above, but (b) the breach is so slight that it would be unreasonable for him to reject them, then, if the buyer does not deal as a consumer, the breach is not to be treated as a breach of warranty." However, it is submitted in A.G. Guest, supra n.4 at pp.1180-83, 1390 that this Section should not apply to international sale of goods transactions. The submission is justified by the certainty need in international sales. The machinery of excluding this Section was suggested, at p.1182, to be that parties to international sales on typical CIF or FOB terms "must be taken to have impliedly agreed to exclude the statutory restriction [Section 15A] on the right to reject."

rejection of such goods, the buyer might not have had the right to reject them. The documents in such a case may not be defective and the defect of the goods does not justify their rejection. However, in certain cases, the buyer may be entitled to reject documents which reveal the defect of the goods even though the defect of the goods does not justify their rejection. This can be in cases where such documents, by revealing the defect of the goods, become defective. For example, in *Cehave N.V. v. Bremer Handelsgesellschaft* (*The Hansa Nord*)[97] it was held that the CIF buyer was not entitled to reject the goods although they were not shipped in good condition as required by the contract. The seller's breach was of intermediate term which did not *as a matter of law* justify rejection. However, it was made clear in that case that the buyer could have rejected the bill of lading if it had revealed the defect of the goods.[98] In fact, the seller in this case was required under the contract to deliver a clean bill of lading.[99] Had the bill of lading revealed the fact that the goods were not shipped in good condition, the bill of lading would have been defective and the seller would have been in breach of his duty to tender a clean bill of lading. In such a case, the buyer would have the right to reject the documents regardless of the fact that the defect of the goods does not justify their rejection.

Therefore, it should be clear that the documents can be considered defective for the reason that they reveal the defect of the goods although such a defect does not justify the rejection of the goods. The buyer is entitled to reject such documents even though the defect of the goods does not *as a matter of law* justify the rejection of such goods. In such cases, if the documents did not reveal the defect of the goods and the buyer paid against such documents, his right to reject the documents would be lost. If the buyer discovers that he paid against such documents before the time of delivery of goods, will he be entitled to damages for loss of the right to reject? In light of the fact that in such cases the buyer will not be able *as a matter of law* to reject the goods, the rule of *Kwei Tek Chao* should be applied to entitle the buyer for his market loss regardless of the fact that he became aware of the seller's breach by the time of accepting the goods. In such cases, the rule of *Kwei Tek Chao* is of vital significance. The causal link in such cases is

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[97] [1976] QB 44.

[98] *Cehave N.V. v. Bremer Handelsgesellschaft* (*The Hansa Nord*) [1976] QB 44, 70. See also A.G. Guest, supra n.4 at p.1347.

[99] The "clean bill of lading is one that does not contain any reservation as to the apparent good order or condition of the goods, or packing." *British Imex Industries Ltd. v. Midland Bank Ltd.* [1958] 1 QB 542, 551 per Salmon J.

established since the buyer's market loss resulted from his loss of the right to reject the documents. The buyer did not have *as a matter of law* the right to reject the documents.

Finally, is the buyer entitled to damages for his market loss in cases where he was aware of the non-conformity of the documents and, nevertheless, accepted them? The answer seems to be in the negative although the decision in *Kleinjan & Holst N.V. Rotterdam v. Bremer Handelsgesellschaft m.b.H.*[100] answers this question in the positive. In this case, the buyers paid the price against documents which revealed the defect of the goods.[101] However, the buyers reserved their rights. In this case, the buyers could have rejected the documents and avoided their market loss. Therefore, it is odd to say that they lost their right to reject the documents or the goods. However, the buyers accepted the goods and sued for damages for their market loss. Obviously, their market loss resulted from their acceptance of the documents and goods. Nevertheless, the buyers were awarded damages for their market loss. Cooke J found, from the exchange of telex messages, that the parties agreed with the sellers on reserving their rights.[102] He said that "[b]y that agreement the rights of the buyers are reserved. Where a person's rights are reserved then *prima facie* it is all of his rights which are reserved and not merely some of them. I think that all of the buyers' rights were reserved in this case including their right to recover damages for the seller's breach of contract in failing to tender [conforming] shipping documents."[103]

The statement of Cooke J sounds accurate but its application, with many respects, was doubtful. Obviously, in *Kleinjan* the buyers reserved their rights to claim damages for losses resulting from the defective documents. In fact, they did not reserve any right other than the rights they had without reservation.[104] The measure of damages here is the difference between the value of the documents and the value they would have had if they had been as warranted. The view of Cooke J was criticised in *Vargas Pena*

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[100] [1972] 2 QB 11.
[101] The documents showed that the goods were shipped on a ship other than the one specified in the contract.
[102] *Kleinjan & Holst N.V. Rotterdam v. Bremer Handelsgesellschaft m.b.H.* [1972] 2 QB 11, 21.
[103] Ibid, p.21.
[104] In *Vargas Pena Apezteguia Y Cia Saic v. Peter Cremer G.M.B.H.* [1987] 1 Lloyd's Rep. 394, Saville J, at p.399, said "I should add that to my mind acceptance of the documents together with a reservation of all rights would *(in the absence of a special agreement made with the sellers)* make no difference where the buyers know the true position: they can only reserve what rights they have—if they choose to accept the documents with knowledge of the breach, then the rights they have are the rights attached to that case, and *not those that would exist if they had taken a different course of action*." [Emphasis added].

Apezteguia Y Cia Saic v. Peter Cremer G.M.B.H.[105] In *Vargas Pena,* where the buyer accepted documents which *on their face* revealed the defect of the goods, the buyer was not entitled to damages for his market loss.[106] The buyers would be rightfully entitled to damages for their market loss if there was an agreement to reserve their rights for such damages.[107] Such an agreement cannot be found in the reported facts of the case.[108] It is submitted that the buyers in *Kleinjan* were overcompensated by entitling them to damages for losses which were not caused by the seller's breach. Indeed, the seller should not be held liable for losses which did not result from his breach.

To sum up, damages for loss of the right to reject should be confined to cases where the seller is in double breach, as to the documents and goods, provided that the first breach, i.e. as to the documents, conceals the defect of the goods and the buyer could not reasonably discover such a defect before accepting the goods. The rule of *Kwei Tek Chao v. British Traders Ltd*[109] should be confined *only* to cases where the buyer cannot *as a matter of law* reject the goods and the documents would be defective if they revealed the non-conformity of goods. By this way, it is submitted, the law will achieve the objective of damages, as stated in *Robinson v. Harman,*[110] and avoid holding the seller liable for losses which did not result from his breach.

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[105] [1987] 1 *Lloyd's Rep.* 394.

[106] In *Vargas Pena Apezteguia Y Cia Saic v. Peter Cremer G.M.B.H.* [1987] 1 Lloyd's Rep. 394, Saville J, at p.399, said "[i]f the buyers know of the breach... there is then no causal connection between the breach and the loss of the right to reject. The buyers know that they may reject if they wish to do so—the breach does not cause them to accept the documents. In such a case to award damages where the documents have been accepted on the basis of the difference between the contract and market prices at the date of the breach is to award damages that simply do not flow from the breach. The damages that flow from the breach in such circumstances are represented (in the ordinary case at least) by the difference between the value of the goods as warranted and their value in fact."

[107] See Michael Bridge, supra n.9 at p.366.

[108] In *Kleinjan & Holst N.V. Rotterdam v. Bremer Handelsgesellschaft m.b.H.* [1972] 2 QB 11 Cooke J carried on to consider the case of *James Finlay & Co. Ltd. v. N. V. Kwik Hoo Tong Handel Maatschappij* [1928] 2 K.B. 604. He said, at p. 22, "In my view, the decision in *Finlay's* case lays down a general rule as to the measure of damages in cases where the sellers have broken a condition of the contract by failing to tender proper documents and the buyers, not having rescinded, are entitled to recover damages for the breach. The reasons why the buyers have not rescinded are immaterial. Whether they have been misled or have elected not to rescind with full knowledge of the facts the position is the same, namely, that if they had rescinded, they would not have had to pay a price (viz. the contract price) in excess of the market price of the goods at the time of the breach." This view is satisfactorily criticised in A.G. Guest, supra n.4 at p.1389 on the ground that the reasoning of the award can apply where there is only a single breach as to the goods. In this case, if the buyer rescinded, he would not have to pay the price.

[109] [1954] 2 QB 459.

[110] (1848) 1 Exch 850, 855. Supra, p.1.

2.5.4 Damages for other Losses

Damages for loss of the right to reject seems to be calculated on the basis of the difference between the contract price and the market price.[111] The time of the market varies from one case to another depending on the time when the buyer discovers the defect or the time when he resells the goods. Therefore, in *Kleinjan & Holst N.V. Rotterdam v. Bremer Handelsgesellschaft m.b.H.,*[112] the time of delivering the documents was considered since the buyers were aware of the sellers' breach before accepting such documents.[113] In *Kwei Tek Chao v. British Traders Ltd,*[114] where the buyer became aware of the breach after he had accepted the documents, the market price at the time of delivery of goods was considered for calculating the market loss.[115] However, in the leading case of *James Finlay & Co. Ltd. v. N. V. Kwik Hoo Tong Handel Maatschappij,*[116] the market price at the time of resale was considered. This was the relevant time as the buyers were not aware of the sellers' breach by that time. As the decision in *Kleinjan* is unlikely, or it is hoped not, to be found in future case reports, one may conclude that the time of the market price should be *prima facie* the time of delivery of goods or the time of resale if it was not reasonable for the buyer to discover the seller's breach by the time of resale.

Apart from damages for market loss, the buyer may claim damages for diminution in value of the goods and for any consequential loss resulting from the seller's breach such as, loss of resale or loss of use of the goods in question. In the cases where damages for market loss was awarded, e.g. *James Finlay,* there was no diminution in value of the goods due to their defect. However, where the defect causes diminution in value, he may claim damages for his market loss and the diminution in value. Where the buyer is entitled to damages for diminution in value and for his market loss, he will recover, as damages, the difference between the contract price and value of the goods as defective. The buyer may also be entitled to recover, as damages, his market loss and the cost of cure where the cost of cure displaces the *prima facie* measure, as discussed in chapter three.[117]

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[111] The relevant market is normally the market available at the destination port.
[112] [1972] 2 QB 11.
[113] *Kleinjan & Holst N.V. Rotterdam v. Bremer Handelsgesellschaft m.b.H.,* [1972] 2 QB 11, 22.
[114] [1954] 2 QB 459.
[115] *Kwei Tek Chao v. British Traders Ltd.* [1954] 2 QB 459, 494.
[116] [1928] 2 K.B. 604.

2.5.5 Damages for Loss of the Right to Reject under the UCC and the CISG

The remedy of damages for loss of the right to reject has not been discussed under the UCC or the CISG. Under the UCC, the CIF seller must "forward and tender with commercial promptness all the documents in due form and with any endorsement necessary to perfect the buyer's rights."[118] The CIF buyer, unless otherwise agreed, "must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents."[119] In view of that, where the documents are, *on their face*, in conformity with the contract, the buyer must pay the price against them. The buyer must pay before inspecting the goods and "assert his remedy against the seller afterwards unless the non-conformity of the goods amounts to a real failure of consideration."[120]

Under the UCC, the buyer cannot revoke his acceptance of documents even in cases where the documents are discovered to be defective after their acceptance. In such cases, if there is a fall in the market price, can the buyer recover, as damages, his market loss which could have been avoided by rejecting the defective documents? To my knowledge the question has not been raised before the American courts. In my meeting with Professor White[121] at the University of Michigan,[122] he suggested that there is nothing to prevent the court from awarding damages for loss of the right to reject under Section 2-714 of the UCC.[123] The Section, which allows damages for any non-conformity of tender, leaves it open for the court to quantify damages in a manner which is reasonable. However, it should be remembered that under Section 2-608 of the UCC the buyer may revoke his acceptance of goods in certain cases as discussed above.[124] In such cases, the buyer will have the chance to avoid his market loss by revoking his acceptance. If the buyer can revoke his acceptance and elects not to do so, it may become hard to establish

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[117] Infra, p.77.
[118] Section 2-320(2-e) of the UCC.
[119] Section 2-320(4) of the UCC.
[120] Comment 12 to Section 2-320 of the UCC.
[121] White, James J. is a Professor in commercial law at the University of Michigan. He has written on many aspects of commercial law and has published the most widely recognized treatise on the Uniform Commercial Code, Handbook of the Law under the Uniform Commercial Code (with Summers, 1995, 4th ed.).
[122] The meeting was at the University of Michigan in September 1999.
[123] Infra, p.53.
[124] Supra, p.25.

a causal link between the seller's breach and the buyer's market loss.[125] In such a case, the buyer's loss is caused by his own choice to retain the defective goods.[126]

As for the CISG, Article 58(2) provides that "[i]f the contract involves carriage of the goods, the seller may dispatch the goods on terms whereby the goods, or documents controlling their disposition, will not be handed over to the buyer except against payment of the price." One of the obligations of the CIF seller is to procure a contract of affreightment to deliver the goods to the destination mentioned in the contract.[127] Under Article 49 of the Convention the buyer will be entitled to avoid the contract if the nonconformity of the documents amounts to a "fundamental breach" of the contract.[128] As regards the definition of the term "fundamental breach", Article 25 provides that "[a] breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract...." Obviously, under such a definition it seems hard to predict what may amount to fundamental breach. As for defective documents, Professor Schlechtriem[129] makes it clear that where payment is agreed to be made against documents, the documents must be regarded as fundamental within the meaning of Article 25.

Therefore, under the CISG, where the documents are defective, the buyer can reject them. Where the buyer loses his right to reject defective documents, since they appear *on their face* to be in conformity with the contract, can the buyer recover his market loss which could have been avoided by rejecting the documents? Article 74 of the CISG[130] seems wide enough to allow the buyer such damages. The point has not been discussed under the CISG but there is nothing to prevent the court from awarding such damages under Article 74 of the CISG as long as such damages comply with the normal

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[125] This does not apply to cases where the buyer discovers the breach after reselling the goods to a third party. In such cases, the buyer cannot revoke his acceptance since he cannot make the goods in question available to the seller.

[126] See the argument regarding the case of *Kwei Tek Chao v. British Traders and Shippers, Ltd.* [1954] 2 QB 459. Supra, pp.35-40.

[127] See J.D. Feltham, 'C.I.F. and F.O.B. Contracts and the Vienna Convention on Contracts for the International Sale of Goods' [1991] *JBL* 413, 418-9.

[128] Article 49 of the Convention provides that "[t]he buyer may declare the contract avoided: (a) if the failure by the seller to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract..."

[129] Peter Schlechtriem, supra n.23 at p.420.

[130] See Article 74 of the CISG, infra, p.53.

restrictions[131] imposed on their recovery.[132] In fact, Article 74 of the Convention makes it clear that the buyer should be entitled to recover for the losses caused by the seller'd breach. In order to achieve such an objective, the buyer should be entitled to damages for 'loss of the right to reject' under the Convention.

Conclusions

'Incidental loss' stated in the UCC is unlikely to result in cases of defective goods. This can be understood from the nature of such a loss as it is concerned with expenses incurred in cases where the buyer rejects the goods. Therefore, the following chapters will deal with two kinds of loss, i.e. normal and consequential losses. As regards the applicability of the CISG to consumer sales, this chapter hopefully explained that the CISG is unlikely to apply to consumer sales due to the strict limitations imposed, by its own provisions, on its application to consumer sales. Therefore, where an argument, raised in the following chapters, distinguishes between consumer and commercial cases, it has to be remembered that conclusions reached regarding consumer cases may not apply under the CISG.

'Loss of the right to reject' may result in cases of defective quality of goods where the seller is entitled to receive the price against documents which include a quality certificate. This is quite common in certain sales, such as sale of oil. In applying the principle of *Robinson v. Harman,*[133] one should consider the losses *caused* by the seller's breach. It is submitted that in two cases, i.e. *Kwei Tek Chao v. British Traders Ltd.*[134] and *Kleinjan & Holst N.V. Rotterdam v. Bremer Handelsgesellschaft m.b.H.,*[135] the buyer was overcompensated by entitling him to damages for losses which did not result from the seller's breach. Professor Bridge satisfactorily criticises the decision in *Kwei Tek Chao* on the grounds that the causal link between the seller's breach and the buyer's loss did not exist.

Damages for loss of the right to reject, it is submitted, should be awarded *only* where the seller is in double breach, as to the documents and goods, provided that the first breach, i.e. as to the documents, *concealed the defect in the goods and the buyer could not*

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[131] Infra, p.277.
[132] J.D. Feltham, supra n.127 at p.422.
[133] (1848) 1 Exch 850, 855. Supra, p.1.
[134] [1954] 2 QB 459.

reasonably discover such a defect before accepting the goods. An exception to the last condition, i.e. the buyer could not reasonably discover the defect of the goods by the time of their acceptance, is the case where the buyer cannot *as a matter of law* reject the goods and the documents would be defective if they revealed the non-conformity of goods. In such a case, the buyer would not be able to reject the goods and avoid his market loss even if he discovered their defect before accepting them. Therefore, in such a case, the rule of *Kwei Tek Chao v. British Traders Ltd*[136] may apply to allow the buyer damages for his market loss. By this way the court will achieve the objective of compensatory damages, as stated in *Robinson,* and at the same time avoid overcompensating the buyer.

Finally, it does not seem possible to compare English law with the UCC and the CISG regarding the recoverability and quantification of damages for 'loss of the right to reject' due to the fact that this point has never been raised under the UCC or the CISG. However, as mentioned above, in my meeting with Professor White at the University of Michigan, he suggested that there is nothing to prevent the American courts from awarding such damages under the UCC as long as the loss complies with the normal restrictions imposed on the recovery of damages. In fact, it is too hard to tell whether or not the American courts would award damages for 'loss of the right to reject', if such damages were claimed. However, as this chapter argues that the buyer should not be entitled to such damages where he could reject the goods, it can also be argued that the American court should not allow such damages where the buyer can reject or revoke his acceptance of the goods. Indeed, deciding otherwise may result in overcompensating the buyer by holding the seller liable for losses which did not result from his breach. As explained above, in certain circumstances, Section 2-608 of the UCC allows the buyer to revoke his acceptance.

As regards the CISG, there is nothing to prevent the court from awarding such damages under Article 74. In fact, this Article allows the buyer damages for all losses caused by seller's breach as long as such losses comply with the normal restrictions imposed on the recovery of damages. Therefore, the arguments produced in this chapter regarding

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[135] [1972] 2 QB 11.
[136] [1954] 2 QB 459.

damages for 'loss of the right to reject' should apply under the CISG in order to avoid overcompensating or undercompensating the buyer.

Chapter Three

Recoverability of Damages for Diminution in Value: Displacement of the *Prima Facie* Measure

Introduction

Chapter one of this thesis stated that the balance for the law, in awarding compensatory damages, is to ensure that the objective of compensatory damages, as stated in *Robinson v. Harman*,[1] is achieved and the buyer at the same time is not overcompensated. The issue of this chapter is whether or not the law strikes the right balance in cases of normal loss, i.e. diminution in value. Commonly, damages for diminution in value are quantified under a *prima facie* measure stated in the SGA and the UCC. The CISG does not provide a measure of damages in cases of breach of warranty of quality. Therefore, one may need to find out how damages can be quantified in such cases under the Convention.

As the *prima facie* measure applies under both of the SGA and the UCC, it is intended to find out whether such a measure has similar application in English and American cases. Where it is thought that the application of the *prima facie* measure by American courts is improper or different from the application of such a measure by English courts, it becomes necessary to deal with the American cases separately. The obvious example is the UCC cases mentioned below where the buyer obtained double recovery for the same loss. Such cases will be examined in order to be relied on in concluding, at the end of this chapter, which law deals better with the application of the *prima facie* measure.

A significant question under the *prima facie* measure is whether the objective or the subjective value of goods should be considered in order to achieve the purpose of compensatory damages stated in *Robinson.* In most cases, goods have one value whether they are valued subjectively or objectively. However, in certain cases, the subjective value may exceed or be less than the objective value. Therefore, in such cases, valuing the goods subjectively may increase or reduce the buyer's damages. In this chapter, it is

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[1] (1848) 1 Exch 850, 855. Supra, p.1.

intended to find out the circumstances under which the subjective value *should* be considered in order to achieve the purpose of compensatory damages. Moreover, it is necessary to specify the time and place at which the goods should be valued and to deal with the question of whether such a time and place vary depending on the circumstances of each case.

Damages for diminution in value may not be allowed in cases where their award would overcompensate the buyer. This would be the case where the actual loss of the buyer is not the diminution in value. The recent case of *Bence Graphics International Ltd. v. Fasson UK Ltd*[2] demonstrates how subsales can be considered to disallow the buyer damages for diminution in value. The decision in *Bence* has been criticised by respected writers, such as Treitel.[3] However, it will be argued that the decision in *Bence* allowed the buyers damages for their actual loss. Furthermore, it seems possible to argue that reaching a different conclusion in a case such as *Bence* will clash with the objective of compensatory damages stated in *Robinson.* This work will produce an argument to support the decision of the Court of Appeal in *Bence* which is in contradiction to the decision of the same Court in *Slater v. Hoyle & Smith Ltd.*[4]

The objective of damages, as stated in *Robinson,* cannot be achieved by awarding the difference in market value where the actual loss of the buyer is the cost of cure. The cost of cure may exceed or be less than the diminution in value. The question is essentially whether the objective of damages can be achieved by allowing the buyer damages for diminution in value or cost of cure. The decision of the House of Lords in the recent case of *Ruxley Electronics and Construction Ltd. and another v. Forsyth*[5] considered the restriction of reasonableness which is imposed on the recovery of damages calculated on the basis of cost of cure.

Where the buyer suffers normal loss and consequential loss of profit, can he recover damages for both losses? The answer to this question depends on whether the buyer claims damages for loss of gross earnings or net profit. This chapter will distinguish between gross earnings and net profit and deal with the case where the buyer seeks to

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[2] [1997] 1 All ER 979.
[3] G.H.Treitel, 'Damages for Breach of Warranty of Quality' (1997) 113 *LQR* 189.
[4] [1920] 2 KB 11.
[5] [1996] 1 AC 344.

recover for loss of gross earnings and diminution in value and/or expenses incurred in reliance on the contract. It will be argued that allowing the buyer damages for all these losses will overcompensate him. The following chapter will examine the case where the buyer seeks to recover for his loss of net profit and for the diminution in value of the defective goods and/or for wasted expenses incurred in reliance on the contract.

3.1 The Basic Rule of Damages for Breach of Warranty of Quality

Section 53(2) of the SGA provides

> "The measure of damages for breach of warranty is the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty."

Section 53(2) lays down the basic rule of damages in terms of *Hadley v. Baxendale.*[6] The Section seems to state the first part of the rule of *Hadley* which allows damages for losses "arising naturally, i.e. according to the usual course of things"[7] from the breach of contract.[8] This part of the rule allows damages for losses resulting under normal circumstances. However, the Section adds the world 'directly'. This word was not used in the rule of *Hadley.* It is unclear whether the word 'directly' is intended to make any difference from the rule of *Hadley.* In the context of contractual exclusions from liability, Atkinson J, in *Saint Line Ltd. v. Richardson, Westgarth & Co. Ltd.*,[9] said "[d]irect damage is that which flows naturally from the breach without other intervening causes and independently of special circumstances, while indirect damage does not so flow."[10] Under such an interpretation, there seems to be no need to use both the words 'directly' and 'naturally' in Section 53(2) jointly.

Nevertheless, the interpretation of Atkinson J may be suitable for the application of Section 53(2) in the light of the fact that the SGA provides another Section which allows 'special damages'. Section 54 provides

> "Nothing in this Act affects the right of the buyer or the seller to recover interest or special damages in any case where by law interest or special damages may be recoverable...".

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[6] [1854] 9 Exch 341. See A.G. Guest, *Benjamin's Sale of Goods,* London, 5th ed., 1997, p.931.
[7] *Hadley v. Baxendale,* ibid, p.354.
[8] The rule of *Hadley* is discussed in chapter seven at p.284.
[9] [1940] 2 KB 99.
[10] Ibid at p.103.

In this view, Section 53(2) may apply to all losses resulting from breach of warranty under *normal* circumstances. Damages for losses resulting under *special* circumstances can be claimed under Section 54. Therefore, in this thesis, damages for consequential losses resulting under normal circumstances may be awarded under Section 53(2). However, it should be noted that specifying what losses can be awarded under each Section is not significant in practice. The amount of damages is determined according to principles founded by the common law. Probably, this is why Section 53(2) is always dealt with as part of the rule of *Hadley* without considering whether or not the word 'directly' makes any difference.

In all cases, Section 53(2) should be the *starting point* in quantifying damages for breach of warranty. Therefore, the court should not start by considering Section 53(3) which allows the buyer damages for diminution in value. In fact, as discussed below, in many cases the buyer may not be entitled to damages for diminution in value calculated under the *prima facie* measure. This is why Auld LJ, in *Bence Graphics International Ltd. v. Fasson UK Ltd,*[11] made it clear that the starting point in determining damages for breach of warranty should be the rule of *Hadley* and not the *prima facie* measure stated under Section 53(3).[12]

The rule of *Hadley v. Baxendale*[13] is the origin of the provisions of the UCC and the CISG regarding damages for breach of contract. Section 2-714(1) of the UCC is similar to Section 53(2) of the SGA.[14] Section 2-714(1) of the UCC states the basic rule of damages for breach of warranty. Therefore, the Section is applicable to all cases of breach of warranty. This may be quite obvious in cases where the buyer claims damages for losses other than the diminution in value or where the *prima facie* measure is not applicable. As will be explained in the next section, under the UCC, damages for diminution in value are quantified under the *prima facie* measure. As regards the CISG, Article 74 states the basic rule of damages which applies to all cases of defective goods.

Article 74 of the CISG provides

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[11] [1997] 1 All ER 979.
[12] Ibid at p.991.
[13] [1854] 9 Exch 341.
[14] Section 2-714(1) of the UCC provides "Where the buyer has accepted the goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable."

> "Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract."[15]

Under all the mentioned provisions, the buyer is entitled to recover for his actual loss caused by the seller's breach. Allowing the buyer for his actual loss may put him in the same position as if the goods had been delivered as warranted. In this sense, one may state that by applying these provisions the objective of compensatory damages, as stated in *Robinson v. Harman,*[16] can be achieved. However, it should be noted that the buyer may not be entitled to all types of damage caused by the breach. As will discussed below,[17] in certain cases, awarding the buyer for all types of damage may overcompensate him.

3.2 The *Prima Facie* Measure of Damages

Compensatory damages for the normal loss resulting from breach of warranty of quality can be awarded under *prima facie* measure[18] stated in the SGA and the UCC. The *prima facie* measure is designed to achieve the objective of damages, as stated in *Robinson v. Harman,*[19] by awarding the buyer the "difference between the value of the goods as received and the value they would have had if they had been as warranted".[20] Where the diminution in value is the only loss caused by the seller's breach, the difference in value damages may place the buyer in the same position as if the goods had been in conformity with the contract.

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[15] Article 74 of the CISG corresponds to Article 82 of the Uniform Law in the International Sale of Goods (ULIS) which provides "Where the contract is not avoided, damages for a breach of contract by one party shall consist of a sum equal to the loss, including loss of profit, suffered by the other party. Such damages shall not exceed the loss which the party in breach ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters which then were known or ought to have been known to him, as a possible consequence of the breach of contract."

[16] (1848) 1 Exch 850, 855. Supra, p.1.

[17] Infra, p.91.

[18] The *prima facie* measure can be referred to as "the difference in value measure" or the normal measure. It is also known as a "capital value" assessment; see Paul Dobson, *Sale of Goods and Consumer Credit,* London, 5th ed., 1996, p.211.

[19] (1848) 1 Exch 850, 855. Supra, p.1.

[20] Section 53(3) of the SGA and 2-714 of the UCC.

Although the application of the *prima facie* measure achieves the objective of damages, as stated in *Robinson,* in normal circumstances, it may not be the best measure in cases of special circumstances, as discussed below. It should be noted here that the *prima facie* measure is concerned with breach of warranty of quality; but the measure seems to be the normal measure of damages where the goods do not correspond to their description or are not fit for specific purpose agreed on by the parties.[21] In case of delivery by instalments, the *prima facie* measure of damages applies separately to each delivery.[22]

Section 53(3) of the SGA states:

> "In the case of breach of warranty of quality such loss is prima facie the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had fulfilled the warranty."

Section 2-714(2) of the UCC states:

> "The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount."

3.3 The Application of the *Prima Facie* Measure

The application of the *prima facie* measure is straightforward in most cases of breach of warranty of quality. Two elements should be determined for the application of the *prima facie* measure, i.e. the value of the goods and the time and place at which goods are valued. As for the former element, the application of the *prima facie* measure can be relatively difficult where the actual value of the goods is in dispute. As for the latter element, there seems to be a difference between the SGA and the UCC regarding the time at which damages should be quantified.

These elements obviously affect the amount of the recoverable damages and, as a result, their consideration is necessary to achieve the objective of compensatory damages stated in *Robinson v. Harman.*[23] The misapplication of such elements may result in overcompensating or undercompensating the buyer. The following will consider how such elements have been, or should have been, applied in order to strike the right

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[21] Harvey McGregor, *McGregor on Damages,* London, 16th ed., 1997, p.587.
[22] A.G. Guest, *Benjamin's Sale of Goods*, London, 5th. ed., 1997, p.936.

balance in awarding compensatory damages by achieving the objective of such damages and avoiding overcompensating or undercompensating the buyer.

3.3.1 The Concept of Value

The concept of the value of goods is not identified by the SGA, the UCC nor the CISG. A great deal is left to the court to consider the suitable ways of valuing the goods.[24] In the UCC case of *Soo Line Railroad Co. v. Fruehauf Corporation,*[25] the Court said that "[v]alue is described as the highest price in terms of money for which a product would have been sold on the open market..."[26]. Basically, this description indicates one of the ways of valuing the goods, i.e. where there is an available market (the market price). This description of the value seems to be concerned only with the selling price of goods. However, the selling price might be different from the buying price. If this is the case, under which price should the value of the goods be determined? The answer to this question varies from one case to another depending on the intended use of the goods.[27] Where the goods were bought for the purpose of resale, such a value might be decided under the reselling price;[28] on the other hand, if the goods were bought to be used by the buyer, such a value would probably be decided under the buying price. This is understandable on the grounds that the value of the goods should be decided from the buyer's view. This is due to the purpose of awarding compensatory damages in cases of breach of warranty of quality. Damages here are awarded in order to put the buyer, so far as money can do it, in the position he would have been in had the goods been free from defects.

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[23] (1848) 1 Exch 850, 855. Supra, p.1.

[24] Section 1-201(44) of the UCC which deals with the concept of value, is not helpful here. In *Carlson v. Rysavy,* 1978 S.D. LEXIS 296; 23 UCC Rep. Serv. 353 (1978) the Supreme Court of South Dakota stated that "There is no code definition of value applicable to [Section 2-714(2)]. The general definition of value in [Section 1-201(44)] obviously has no relevance here since it looks to the characteristics of an entirely different transaction."[24] Section 1-201(44) of the UCC states "(Value). Except as otherwise provided with respect to negotiable instruments and bank collections... a person gives value to a right if he acquires them
(a) in return for a binding commitment to extend credit or for extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or
(b) as security for or in total or partial satisfaction of a pre-existing claim; or
(c) by accepting delivery pursuant to a pre-existing contract for purchase;
(d) in return for any consideration sufficient to support a simple contract.

[25] 547 F.2d 1365 (8th Cir. 1977).

[26] *Soo Line Railroad Co. v. Fruehauf Corporation,* 547 F.2d 1365 at p.1379 (8th Cir. 1977).

[27] S. M. Waddams, *The Law of Damages,* Toronto, 1983, p.9.

[28] Considering the resale price is subject to the remoteness principle. Under this principle, the resale should be in the contemplation of the parties at the time of making the contract.

In the light of the above discussion, one may state that the goods themselves may have more than one value. The value of the goods for a business buyer, who buys a quantity of goods for the purpose of resale, may be different from the value of the same goods for a consumer buyer. As for the former, such a value might be determined in relation to the wholesale price since this is the price that the business buyer would pay if he obtained the goods from the market. Therefore, in the case of a consumer buyer, the value should be decided in relation to the retail price.[29] Clearly, the price under the wholesale market is normally less than the retail market price since the retailer is expected to gain profit. Therefore, it is plain that in most cases the value of the goods in question from the buyer's view is more than the value of the same goods from the seller's view.

Furthermore, the use of the goods plays a substantial role in their valuation. Some goods can be put to several kinds of use and, thereupon, their value is variable depending on the kind of use they are put to. For example, the value of a car intended to be used in a car race is different from the value of a normal car. In this instance, such kinds of goods should be valued in relation to their use which was known to the parties at the time of making the contract. Here, where there is a dispute on whether the actual use of the goods was known to the parties at the time of making the contract, the court may, unless the intended use is proved, value the goods in relation to the most profitable use to which the buyer could reasonably have put such goods.[30]

The last point, to be considered in this respect, is that the goods may have special value to the buyer which is more or less than their objective value. Here, can such a value be considered for the purpose of applying the *prima facie* measure of damages? This is, once again, left to the courts to determine whether to value the goods subjectively or objectively. The following section is concerned with this point.

3.3.2 Can Damages be Recovered for Loss of 'Consumer Surplus' under the Principle of *Robinson*? Objective or Subjective Valuation of Goods?

Determining the value of goods is the main element in applying the *prima facie* measure. Therefore, the question here is whether the court should consider the

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[29] J.D. Calamari and J.M. Perillo, *Contracts,* West Publishing Co., 2nd ed. 1977, p.537.

subjective value of goods in order to achieve the objective of damages stated in *Robinson v. Harman.*[31] This may be understood from the fact that determining the right value of the goods is necessary to know the potential position of the buyer if the goods had been in conformity with the contract. This requires the court to decide whether or not the subjective value can be considered.

The objective test (the market value), recognized by the measures of damages for non-acceptance and non-delivery, is not adopted expressly by the *prima facie* measure of damages for breach of warranty of quality. It seems that the use of the word 'value' instead of the 'market value' makes the *prima facie* measure unique in the SGA and the UCC. The concept of the market value, in the case of non-delivery, is recognized in order to award the buyer the amount which allows him to obtain substitute goods from the market. However, in cases of breach of warranty of quality, the buyer may retain the defective goods. In this respect, the buyer needs an amount to add to the value of the defective goods in order to be put in the same position he would have been in had the goods been free from defects, i.e. in order to achieve the objective of damages stated in *Robinson v. Harman.*[32] Therefore, valuing what the buyer has and what he should have had is left to the court in order to be achieved according to the circumstances of each case. In other words, the court will decide to apply the subjective or the objective test according to the circumstances of each case.

Businessmen are normally expected to be concerned with the market value of the goods and not to have any emotional attachment to the goods.[33] Therefore, in most cases, goods have the same value whether they are valued subjectively or objectively. However, in cases of consumer contracts, the goods might be of special value to the buyer. In such contracts, the excess utility or subjective value obtained from goods over and above the utility associated with their objective value is called, by economists, "consumer surplus".[34] It has been said that "the consumer surplus expected by a person

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[30] Ibid at p.538. See also the pre-UCC cases of *Campbell v. Iowa Central Ry.,* 124 Iowa 248, 99 N.W. 1061 (1904); *Southwestern Tel. & Tel. Co. v. Krause*, 92 S.W. 431 (1906).
[31] (1848) 1 Exch 850, 855. Supra, p.1.
[32] Ibid, p.855.
[33] R.R.Anderson, 'Incidental And Consequential Damages', (1987) 7 *J.L. & Com.* 327, 331.
[34] D. Harris, A. Ogus and J. Phillips, 'Contract Remedies and Consumer Surplus' (1979) 95 *LQR* 582.

who intends to use a good is an equivalent to the profit which a businessman expects to make from a contract."[35]

In this view, one may note that the objective of compensatory damages, as stated in *Robinson,* cannot be achieved without compensating the buyer for his loss of 'consumer surplus'. Of course, the recovery of damages for loss of 'consumer surplus' is subject to the application of the remoteness principle. The 'consumer surplus' should be in the reasonable contemplation of the parties at the time of making the contract. This may be quite obvious in certain cases such as sales of unique goods which do not have a substitute in the open market. However, where substitute goods are obtainable, the buyer should make it clear to the seller, at the time of making the contract, that the goods are of special value for him in order to be entitled to recover damages for loss of consumer surplus.[36] Furthermore, damages for loss of consumer surplus may be irrecoverable where the defect of the goods can be cured. Here, where the cost of cure is more than the difference in the objective value of the goods as warranted and as defective, the value of consumer surplus is included in such a cost. This point, certainly, needs further examination which can be found below.[37]

One of the difficulties in awarding damages for loss of 'consumer surplus' is its assessment. Due to its nature, 'consumer surplus' is hard to assess. However, economists tend to measure the utility in terms of the maximum amount a consumer would pay for a particular purchase. Under such a measurement, if the objective value of specific goods is £100 but the consumer is willing to pay £150 for it, the surplus will be £50 (£150 [the subjective value] - £100 [the objective value]).[38] Nonetheless, the measurement of the consumer surplus is not as easy as it seems. In most cases, valuing the goods subjectively is an intractable task since the buyer may have the tendency to exaggerate

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[35] Ibid at pp.582-3.

[36] Here, one may suggest that the seller may raise the price if he knows, at the time of making the contract, that the goods are of more value to the buyer than their objective value. However, due to the market competition, the seller may not be able to do so. Most likely, the buyer will obtain the goods from the seller's competitors if the seller tries to raise the price of the goods. See Timothy J. Muris, 'Cost of Completion or Diminution in Market Value: the Relevance of Subjective Value' (1983) 12 *J. Legal Stud.* 379, 386.

[37] Infra, p.78.

[38] D. Harris, A. Ogus and J. Phillips, supra n.34.

such a value.[39] Where it is reasonable for the buyer to cure the defective goods, there will be no need, as discussed below,[40] to measure the consumer surplus.

Where the parties do not present any evidence of the subjective value, the court will probably value the goods objectively. Therefore, it is the buyer's responsibility to present sufficient evidence of the subjective value of the goods where such goods are more valuable to him than their objective value.[41] Where the buyer proves that the goods in question mean to him more than their objective value, the issue will be left to the court to decide whether to apply the subjective or objective test depending upon the circumstances of each case. For example, where the buyer shows evidence that the seller was aware, at the time of making the contract, that the goods have a special value to the buyer, the goods will be more likely to be valued subjectively as compared to where the seller was not aware of such a special value at the time of making the contract.

Moreover, the objective of compensatory damages, as stated in *Robinson v. Harman,*[42] will not be achieved without considering the subjective value of the *defective* goods in calculating the buyer's damages. The subjective value of the *defective* goods may exceed or be less than their objective value. Where the defective goods are of more value to the buyer than their market value, the buyer may not be presumed to resell the defective goods at their market price. If this becomes the case, should the court consider their subjective value in applying the *prima facie* measure? Probably the answer would be in the positive. This is understandable on the ground that damages are generally intended to compensate the buyer for the loss he suffered *in fact*. In this instance, the difference between the value of the goods as warranted and their objective value as received might overcompensate the buyer.[43] For example, suppose that the market price of the goods as warranted is £500 and the market price of the defective goods is £200. Suppose further that the defective goods are worth £250 to the buyer. In this case, valuing the defective goods objectively will entitle the buyer to recover £300 (the difference between the value of the goods as warranted and as received). However, the actual loss, that the buyer suffered, is £250 which is the difference between the value of

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[39] See Alexander F H Loke, 'Cost of Cure or Difference in Market Value? Toward a Sound Choice in the Basis for Quantifying Expectation Damages' (1996) 10 *JCL* 189,193.
[40] Infra, p.78.
[41] Ellen A. Peters, 'Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two' (1963) 73 *Yale L.J.* 199, 269.
[42] (1848) 1 Exch 850, 855. Supra, p.1.

the goods as warranted (£500) and the *subjective* value of the goods as received (£250). Possibly, this is the case where the consumer is emotionally attached to the goods. In such a case, it is the seller's burden to prove that the defective goods are of more value to the buyer than their objective value. Here, it should be clear that where the subjective value of the goods as defective is more than their objective value, the goods as warranted are expected to be of a higher subjective value than their objective value. Nevertheless, retaining the defective goods does not indicate that such goods are of a higher value than their market price. The buyer is not required to resell the defective goods in order to obtain damages for breach of warranty of quality. Therefore, one may conclude that the consideration of the subjective value in this case faces the obstacle of proof.

On the other hand, the *defective* goods might be of less value to the buyer than their objective value. In such a case, should the court consider the subjective value for the application of the *prima facie* measure? The answer is likely to be in the negative. One may suggest that, in this case, by applying the objective value of the defective goods, the buyer would be undercompensated. This suggestion may not be accepted on the ground that the buyer in such a case is not presumed to keep the defective goods. Apparently, the buyer does not have any emotional attachment to the goods since their subjective value is less than their objective one. In such a case, the buyer will be most likely to resell the defective goods at their market value or cure them.

Finally, it can be noted that the subjective value must *in principle* be considered in order to achieve the objective of damages stated in *Robinson v. Harman.*[44] However, one finds it difficult to provide certain rules under which the court can choose to apply the objective or the subjective value of the goods. The obvious case is that the buyer may be entitled to damages for loss of 'consumer surplus' where such a 'consumer surplus' was in the contemplation of the parties at the time of making the contract. Furthermore, where there is an available substitute, it seems difficult to allow damages for loss of 'consumer surplus'. This can be understood on the grounds that the buyer can resell the defective goods and obtain a substitute which is up to the specifications of the contract. In such a case, the buyer may be allowed to recover for the expenses incurred to resell

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[43] J.J. White & R.S.Summers, *Uniform Commercial Code*, West Publishing Co., 4th ed., 1995, p.368.
[44] (1848) 1 Exch 850, 855. Supra, p.1.

the defective goods and obtain substitute. Even where the remoteness principle does not arise and substitute goods are unobtainable, the buyer may not be entitled to more than the cost of cure provided that it is reasonable for the buyer to cure the defect as explained below.[45] To sum up, the court will elect the subjective or objective test in order to measure the *actual diminution in value* of the goods from the buyer's view, taking into account the knowledge available to the seller at the time of making the contract.

3.3.3 Burden of Proof as to the Value of the Goods

It is the buyer's burden to present evidence of the difference in value of the goods as received and as warranted. Where the buyer does not present sufficient proof of the difference in value, the court may not award him more than nominal damages. In *Aryeh v. Lawrence Kostories & Sons, Ltd,*[46] where damages were claimed for breach of warranty of quality, it was held that "...there was no evidence as to difference in value of goods delivered and contract goods... therefore, plaintiff was entitled to nominal damages only...".[47]

There is nothing to prevent the buyer from depending on his own experience to value the goods as long as he convinces the court of the actual value of the goods. This has been held in a UCC case where the buyer was allowed to depend on his own experience to show the value of the goods.[48] Actually, this matter was best explained in the UCC case of *Vreeman v. Davis*[49] where the Court made it clear that "[a]n owner is competent to express an opinion on the market value of his or her property, and ordinarily any weakness in the foundation for that opinion goes to its weight, not its admissibility."[50] Here, it should be noted that such a valuation should be produced by a person who has

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[45] Infra, p.83.

[46] [1967] 1 Lloyd's Rep. 63.

[47] *Aryeh v. Lawrence Kostories & Sons, Ltd,* [1967] 1 Lloyd's Rep. 63, 72. In *Aryeh's* case, there was an international sale contract between a British seller and an Iranian buyer. Part of the buyer's claim was for breach of warranty of quality of the goods delivered. The buyer could not show a sufficient evidence of the difference between the actual value of the goods and the value of the goods they would have had if they had been as warranted. As a result, the buyer was not entitled to more than nominal damages in respect to this claim.

[48] In *Royal Furniture Co. v. City of Morgantown* 1980 W. Va. LEXIS 455; 164 W Va. 400 (1980), it was held that since the plaintiffs were prominent merchants for many years, they were certainly qualified to give competent testimony as to the value of their merchandise. Cited in C. A. Cicconi, '*Nelson v. Logan Motor Sales, Inc.*: Providing damages for breach of the implied warranty of merchantability' (1990) 92 *W. Va. L. Rev.* 427, 431.

[49] 1984 Minn. LEXIS 1356; 348 N.W.2d 756 (1984).

enough experience in the type of the goods in question. In another UCC case, *Spencer v. Steinbrecher,*[51] it was held that "[t]here is no reason why an owner cannot testify as to value of his own personal property, but he must, in order to avoid speculation, have enough experience to know values and be able to tell why, so the more frequent method of proof is to have the value testimony produced by persons experienced with the type of property involved...".[52] In this view, goods should be valued with certainty in order to enable the court to assess damages with reasonable certainty as well.[53] In other words, the value of the goods should not be speculative.[54]

3.3.4 Ways of Ascertaining the value

Ways of valuing goods cannot be put in an exhaustive list since they are ever increasing in response to the rapid development of manufacturing new goods. Furthermore, the value of the goods is changeable, as previously mentioned, depending on many factors, e.g. the use of the goods and the nature of the buyer, goods for wholesale or retail sale, etc. The following is intended to state the common ways of determining the value of the goods.

3.3.4.1 Ways of Ascertaining the Value of the Goods as Warranted

Although the *prima facie* measure does not adopt the concept of market value, the market price[55] seems to be the primary evidence of the value of the goods in practice.[56] For example, in the UCC case of *Intervale Steel v. Borg Warner,*[57] the Court held that "[t]he value of goods "as warranted" has been interpreted to encompass two different standards. *The primary standard is the fair market value of the goods* at the time of

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[50] *Vreeman v. Davis,* 1984 Minn. LEXIS 1356; 348 N.W.2d 756 (1984).
[51] 152 W. Va. 490 (1968).
[52] *Spencer v. Steinbrecher,* 152 W. Va. 490 at p.497 (1968).
[53] For the restriction of certainty, see infra p.142.
[54] In the pre-UCC case of *Rodgers v. Bailey,* 1910 W. Va. LEXIS 105; 68 W. Va. 186 (1910), it was held that "In proving compensatory damages, the standard or measure by which the amount may be ascertained must be fixed with reasonable certainty, otherwise a verdict is not supported and must be set aside."
[55] See the following UCC cases where the court considered the market price as an evidence of the value of the goods as warranted: *Brooks Shoe Manufacturing Co., Inc. v. Chesapeake Shoe Co.,* 1982 Bankr. LEXIS 3753; 34 UCC Rep. Serv. 539 (1982); *Chatlos Systems, Inc. v. National Cash Register Corp.* 1980 U.S. App. LEXIS 11901; 30 UCC Rep. Serv. 416 (3d Cir. 1980).
[56] See *Jones v. Just* (1868) 3 QB 197 where the buyers contracted with the seller to purchase a quantity of Manilla hemp which did not correspond to the specifications of the contract. The buyers were entitled, as damages, to the difference between what the hemp was worth when it arrived and what the same hemp would have realised had it been shipped in a state in which it ought to have been shipped.
[57] 578 F. Supp. 1081 (1984).

acceptance. In using the fair market value, the courts ensure that the buyer is only recovering his actual damages and does not gain a windfall from a fluctuating market. *When the fair market value cannot be easily determined, or the parties do not raise it as a measure of 'value',* courts have generally relied on the contract's purchase price as strong evidence of the value of the non-conforming goods as warranted."[58] [Emphasis added].

The second way of determining the value of the goods as warranted is the contract price. The contract price[59] is common evidence of the value of the goods as warranted.[60] It becomes strong evidence where the market price of the goods is not available. This presumably happens where the goods in question are unique, used or especially manufactured. Such goods are not normally obtainable in the open market.[61] To sum up, it can be noted that in the absence of the market for the goods in question, the court may consider the contract price as the primary evidence of the value of the goods as warranted.

In the UCC case of *Intervale Steel v. Borg Warner,*[62] where the buyer had accepted non-conforming steel, the Court found that the proper evidence of the value of the goods as warranted is the contract price for the following reasons: (a) the parties did not present any evidence of the fair market value of the steel had it been tendered as warranted by the seller; (b) it did not appear that the buyer would gain windfall damages if the purchase price was used as the value of the goods as warranted; (c) there was no evidence showed that the contract price was unreasonable for this type of steel.

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[58] *Intervale Steel v. Borg Warner,* 578 F. Supp. 1081 at p.1090 (1984).

[59] Since the buyer, in cases of breach of warranty of quality, does not reject the goods, the contract price cannot be a fixed measure of determining the value of the goods. The basic aim of damages in this case is to entitle the buyer to damages to be added to the value of the goods he received and eventually to be put in the economic position he would have been in if the goods had been free from defects. Comment 7 to Article 70 of the 1978 draft [currently Article 74] of the CISG provides that "... Since this formula [the *prima facie* measure] is intended to restore him to the economic position he would have been in if the contract had been performed properly, the contract price of the goods is not an element in the calculation of the damages...". In the following UCC cases the contract price was accepted as an evidence of the value of the goods as warranted: *Puritan Mfg., Inc. v. I. Klayman & Co.,* 1974 U.S. Dist. LEXIS 7901; 15 UCC Rep. Serv. 1055 (1974); *Auto-Teria, Inc. v. Ahern,* 1976 Ind. App. LEXIS 978; 20 UCC Rep. Serv. 336 (1976); *Long v. Quality Mobile home brokers, Inc.,* 1978 S.C. LEXIS 356; 25 UCC Rep. Serv. 470 (1978).

[60] The "Credit price" which includes finance charges is not suitable as an evidence for the value of the goods as warranted. The contract price should be the cash price that the parties contracted on. Considering the "Credit price" as an evidence of the value of the goods as warranted may award the buyer a windfall damages which equal the finance charges.

[61] The contract price will be of little assistance if it can be shown that the market has fallen before the time of performance. See D. W. Greig, *Sale of Goods,* London, 1974, at p.284.

It seems necessary to apply the mentioned conditions stated in *Intervale* case where the court chooses to apply the contract price. The purpose of such conditions is to avoid overcompensating or undercompensating the buyer in considering the contract price as the value of the goods as warranted.[63] The first condition gives the chance to show evidence that the value of the goods is more than the contract price. The second condition states that the buyer should not be overcompensated by applying the contract price. The contract price may be more than the value of the goods as warranted where the market has fallen before the time of performance or where the buyer has made a bad bargain.[64] If this becomes the case, the difference between the contract price and the value of the goods as defective is more than the actual diminution in value resulting from the breach of warranty of quality. In view of that, it seems fair enough to offer the seller a chance to prove that the contract price is more than the actual value of the goods. This is also the purpose of the third condition which can be fulfilled where the court has not been provided by any evidence which shows that the contract price is not the suitable evidence of the value of the goods as warranted.[65]

Another way of ascertaining the value of the goods as warranted is the resale price. Where the buyer had contracted to resell the "goods as warranted" to a sub-buyer, the resale price might be considered as evidence of the value of the goods as warranted.[66] Clearly, the court may not accept the resale price as evidence of the value of the goods as warranted where the seller shows evidence that the resale price is higher than the reasonable price of the goods. However, the resale price may be considered where the buyer is entitled to damages for his loss of profit on resale. Here, the buyer's damages would be the difference between the resale price and the value of the goods as defective. In such a case, the court will make sure that the recovery for loss of profit complies with the restrictions imposed on the recovery damages. For example, the resale price will not be accepted as evidence of the value of the goods as warranted where the lost profit on

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[62] 1984 U.S. Dist. LEXIS 20620; 38 UCC Rep. Serv. 805 (1984).

[63] In the old case of *Loder v. Kekule* (1857) 3 C.B. (N.S.) 128, the market price of the goods in question, between the time of contracting and the time of delivery, fell. The Court held that the contract price is not a suitable evidence of the value of the goods as warranted.

[64] See D.W. Greig, supra n.61 at p.284.

[65] See the UCC case of *Black v. Don Schmid Motor, Inc.,* 1983 Kan. LEXIS 228; 35 UCC Rep. Serv. 448 (1983). [A case of a sale of mobile home]. In this case the Court decided that the value of the home as warranted, for section 2-714(2) purposes, is the purchase price of the home, absent evidence that the purchase price differs from the warranty value.

[66] Roy Goode, *Commercial Law,* 2nd. ed., 1995, p.406.

resale is too remote. Furthermore, the resale price may not be considered where consequential losses are contractually excluded, expressly or impliedly, from the seller's liability. Loss on resale is a kind of consequential loss as it results from loss of use of the goods in question.

3.3.4.2 Ways of Ascertaining the Value of the Goods as Received

Once again, the market value is the primary evidence here. Where there is an available market for the defective goods, their value will be, *prima facie*, the market price. However, the market price, in this respect, is not common evidence since the market for the defective goods is not normally available.

In some cases, the received goods are worthless due to their defective quality. Where the goods are proved to be without value, such as diseased animals and dangerous chemicals, the application of the *prima facie* measure will allow the buyer damages calculated on the basis of the value of the goods that they would have had if they had been free from defects.[67] However, in normal circumstances, the defective goods are of some value. In the case of second hand goods, it might be sensible to value such goods by looking at the price of new goods and deduct an amount equivalent to the depreciation.[68]

Where the buyer managed to resell the defective goods, the resale price might be, in normal circumstances, a satisfactory evidence of their value.[69] This follows the old saying, "the worth of a thing is the price it will bring". In *Biggin & Co. Ltd. v. Permanite Ltd. and others,*[70] Devlin J. said "[i]f the actual damaged goods are sold with all faults, good evidence can be obtained of the difference in value, but such a sale is not always possible, and a claim for substantial damages cannot be limited to goods which have been sold."[71]

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[67] See *W&W Livestock Enter. Inc. v. Gerald H. Dennler* 1970 Iowa Sup. LEXIS 896; 8 UCC Rep. Serv. 169 (1970), (court noted "dead pigs have no value"); *Swenson v. Chevron Chemical Co.*, 1975 S.D. LEXIS 170; 18 UCC Rep. Serv. 67 (1975) (a farmer who paid $717 for defective pesticide is entitled to recover that amount).

[68] M. G. Bridge, *The Sale of Goods,* Oxford, 1997, 592.

[69] S. M. Waddams, supra n.27 at p.152.

[70] [1951] 1 KB 422.

[71] Ibid at p.438.

The sub-buyers should be aware of the defect of the goods in order to consider the resale price as evidence of the value of the goods as defective. Here, it should be the buyer's responsibility to inform the sub-buyer's of the defective quality of the goods.[72] This may be of a vital significance for the purpose of the application of the mitigation principle. Under the mitigation principle, the buyer may not be entitled to recover for his liability to a sub-buyer for losses resulted after the buyer became aware of the defective quality.[73] Furthermore, the court may not accept the resale price as evidence of the value of the goods as defective where it is unreasonable. The price is normally reasonable where the defective goods are sold in a competitive market within a reasonable time after delivery.[74] As the *prima facie* measure applies at the time of delivery, or acceptance under the UCC, the resale should be within a reasonable time after delivery. This may be necessary in cases of perishable goods which depreciate rapidly. In such a case, the price of the goods may decrease rapidly after the time of delivery.[75] However, the resale price may be considered as evidence of the value of the goods even in cases of late resale where such a resale is delayed by the seller's negotiation with the buyer.[76]

3.3.5 Time and Place at which Goods are Valued

The time at which goods are valued is of vital significant for assessing compensatory damages in order to comply with the principle of *Robinson v. Harman.*[77] Clearly, in cases where the market price fluctuates, the value of the goods may vary depending on the time at which the goods are valued. Therefore, the amount of damages may be highly affected by the time of valuing the goods.

Under the SGA, the *prima facie* measure applies at the time of delivery while it applies at the time of acceptance under the UCC.[78] In normal circumstances, delivery and acceptance are made at the same time. Anyhow, the time of measuring the difference in value should be the time when the buyer has a reasonable opportunity to discover the defects. So, the court may depart from the *prima facie* measure to measure the

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[72] R.R.Anderson, 'Buyer's Damages for Breach in Regard to Accepted Goods' (1987) 57 *Miss. L.J.* 317, 347.
[73] Infra, p.298.
[74] R.R.Anderson, supra n.72 at p.347.
[75] Special Project, 'Article Two Warranties in Commercial Transactions' (1978) 64 *Cornell L. Rev.* 30, 115.
[76] Infra, p.73.
[77] (1848) 1 Exch 850, 855. Supra, p.1.
[78] Sections 53(3) of the SGA and 2-714(2) of the UCC.

difference in value at the time of discovering the defect where such a time is different from the time of delivery or acceptance.

In international sales, the time of delivery can be the time when the seller delivers the goods to the first carrier. This may also apply to domestic distance sales. Under such sales, the time of delivery can be the time when the seller delivers the goods to the carrier. However, it is unlikely that the goods will be valued at that time.[79] In such sales, the buyer may not have the opportunity to examine the goods until the time of their arrival. Here, it should be clear that the buyer is not deemed to have accepted the goods "until he has had a reasonable opportunity of examining them for the purpose... of ascertaining whether they are in conformity with the contract...".[80] In this case, the court may apply the *prima facie* measure at the time when the buyer takes possession of the goods on the ground that this is the time when the buyer may have a reasonable chance to discover the defects of the goods.[81] In normal circumstances, this would be the time of acceptance. International sales are just one case where the difference in value is measured at other than the time of delivery or acceptance. Further cases are examined below.[82]

As for the place of determining the value, under the UCC, the *prima facie* measure applies at the place of acceptance[83] while under the SGA such a place is not provided.[84] However, determining the place of valuing the goods is not of vital significance since it

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[79] See Christian Twigg-Flesner and Robert Bradgate, 'The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees-All Talks and No Do?' (2000) *Web JCLI* section 4(a); available at <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html>.

[80] Section 35(2) of the SGA provides:
"Where goods are delivered to the buyer, and he has not previously examined them, he is not deemed to have accepted them under subsection (1) above until he has had a reasonable opportunity of examining them for the purpose- (a) of ascertaining whether they are in conformity with the contract, and...".
Section 2-606 of the UCC states:
"Acceptance of the goods occurs when the buyer (a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity...".

[81] A.G. Guest, supra n.22 at pp.936, 1385; see also *Marimpex Mineralöl Handelsgesellschaft m.b.H v. Louis Dreyfus et Cie Mineralöl G.m.b.H.*, [1995] 1 Lloyd's Rep. 167. In this case, the buyer purchased Russian gasoil under c.i.f. contract. The contract was governed by English law. The buyer was awarded the difference in value damages calculated at the time and place of their arrival at the destination port.

[82] Infra, p.70.

[83] Section 2-714(2) of the UCC provides that "[t]he measure of damages for breach of warranty is the difference at the time and place of acceptance...".

[84] See Section 53(3) of the SGA.

is normally the place of the available market for the goods.[85] Deciding the relevant market depends on the circumstances of each case.

To sum up, it can be noted that it is more appropriate to consider the time of acceptance, rather than the time of delivery, in calculating the buyer's damages. As discussed above, in certain cases the buyer may not be able to discover the defect of the goods at the time of delivery. However, the difference between the SGA and the UCC in this respect is not practically significant since the measure of damages is *prima facie*. Normally, the court values the goods at the time when the buyer has a reasonable chance to discover the defect of the goods. This can be the time when the buyer decides to resell the defective goods and obtain substitute. Therefore, this seems the right practice in order to ensure that the objective of damages, as stated in *Robinson v. Harman,*[86] is achieved by placing the buyer in the same position he would have been in if the goods had been free from defects.

3.3.6 The Application of the *Prima Facie* Measure under the CISG

As stated in chapter one of this research, the objective of damages under Article 74 of the CISG is to compensate the buyer for his actual loss resulting from the seller's breach. Allowing the buyer damages for his actual losses may put him, so far as money can do it, in the same position he would have been in if the goods had been delivered as warranted. In other words, awarding the buyer damages for his actual losses may achieve the objective of damages stated in *Robinson v. Harman.*[87]

The CISG does not provide a specific measure for quantifying damages in cases of breach of warranty of quality. Therefore, the court must calculate such damages in the manner which is best suited to the circumstances.[88] Here, the *prima facie* measure is not the basic method of assessing damages under the CISG. Nevertheless, where the goods have a recognized value which fluctuates, the *prima facie* measure would probably apply to award the buyer damages for diminution in value.[89] In normal circumstances,

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[85] For ways of ascertaining the value of goods, see supra p.61.
[86] (1848) 1 Exch 850, 855. Supra, p.1.
[87] Ibid, p.855.
[88] Albert H. Kritzer, *Guide to Practical Applications of the United Nations Convention on Contract for the International Sale of Goods*, 1989, p.475.
[89] Comment 7 of the Secretariat Commentary to Article 70 of the 1978 draft [currently Article 74] of the CISG provides "If the goods delivered had a recognized value which fluctuated, the loss to the buyer

the buyer may be entitled to recover the difference in value of the goods as warranted and as received. Since by doing so, the buyer may be put in the same position he would have been in if the goods had been defect free. However, the time and place at which goods are valued are not specified by the Convention. Specifying the time at which damages are measured may be of vital significance in cases where the goods fluctuate substantially in value.[90] A footnote to the 1978 commentary on Article 70 of the 1978 draft [currently Article 74] of the CISG states that the CISG gives no indication of the time and place at which "the loss should be measured. Presumably it should be at the place the seller delivered the goods and at an appropriate point of time, such as the moment the goods were delivered, the moment the buyer learned of the non-conformity of the goods or the moment that it became clear that the non-conformity would not be remedied by the seller under article 35, 42, 43 or 44, as the case may be."[91] As previously mentioned, the place at which goods are valued may not be the place of delivery where the available market for the goods is elsewhere. As for the time of calculating damages, there seems to be no clear-cut time provided for the assessment of damages under the CISG.[92] Therefore, where the court applies the *prima facie* measure, valuing the goods in question can be at the time which is most appropriate in the light of the circumstances of each case.

The appropriate time is not necessarily the time of delivery or acceptance. It is the time when the buyer has a reasonable opportunity to discover the defect of the goods. This may be the time when the buyer has physical possession of the goods. Moreover, the goods may be valued at a point of time after putting them to their use. For example, suppose that an American buyer has purchased machinery from a French seller in order to use it in his factory. Suppose further that the machinery appears defective within a reasonable time after the buyer installs it in his factory. In this example, if American law is applicable under private international law, the CISG will be applied since it has been ratified by the USA. The buyer may claim damages for breach of warranty of quality.

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would be equal to the difference between the value of the goods as they exist and the value the goods would have had if they had been as stipulated in the contract...". See also H.M. Flechtner, 'Remedies under the New International Sales Convention: The Perspective from Article 2 of the U.C.C.' (1988) 8 *J.L. & Com.* 53, 107.

[90] H. Gabriel, *Practitioner's Guide to the Convention on Contracts for the International Sale of Goods (CISG) and the Uniform Commercial Code (UCC),* New York, 1994, p.231.

[91] *Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat,* Commentary on Article 70 [Article 74 of the current CISG], n.2.

[92] See J.S. Sutton, 'Measuring Damages under the United Nations Convention on the International Sale of Goods' (1989) 50 *Ohio St. L.J.* 737, 743; Albert H. Kritzer, supra n.88 at p.476.

The *prima facie* measure of damages may be applied in order to award the buyer for the diminution in value of the machinery. The diminution in value of the machinery may vary depending on the time at which the machinery is valued especially where the market price of the machinery fluctuates. In this hypothetical example, it seems unfair to measure the diminution in value at the time of delivery or acceptance since the defect of the goods was not discernible by the time of putting the machinery to its stipulated use. In such a case, the court will be likely to measure the diminution in value at the time of discovery of the defect.

Nonetheless, it should be noted that the *prima facie* measure might not apply under the CISG in certain circumstances. For example, the court may find that the suitable measure of damages is the cost of cure of the defective goods. Comment 6 to Article 70 of the 1978 draft [currently Article 74] of the CISG states that "[w]here the seller delivers and the buyer retains defective goods, the loss suffered by the buyer might be measured in a number of different ways. If the buyer is able to cure the defect, his loss would often equal the cost of the repairs..."[93]. The comment plainly deals with the obvious case where the cost of cure equals the diminution in value. The comment does not deal with cases where the cost of cure exceeds or is less than the diminution in value. Nevertheless, the words of Article 74 of the Convention are broad enough to allow the court to award damages for the *actual* loss under the normal restrictions[94] imposed on the recovery of damages. Therefore, if the court finds that the buyer's actual loss is the cost of cure and not the diminution in value, it is likely to allow the recovery of the cost of cure under Article 74 of the CISG. As discussed below, certain circumstances may indicate that the cost of cure is the *actual loss* of the buyer.[95]

3.4 Modification or Displacement of the *Prima Facie* Measure

"[I]t's for the court to determine the correct measure of damage, not the aggrieved party."[96] Although the *prima facie* measure applies in the majority of cases of breach of warranty of quality, the measure seems to be not exclusive.[97] There are certain cases

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[93] Document *A/CONF.97/5*.
[94] Infra, p.277.
[95] Infra, p.77.
[96] *Bence v. Fasson* [1997] 1 All ER 979, 989.
[97] M.J. Staff, 'the Consequences of Consequential Damages: A Survey of Buyer's Damages under Chapter 2' (1982) 45 *Tex. B. J.* 1211, 1213. The Texas Business and Commerce Code is the Texas' version of the

where special circumstances[98] lead to the displacement or modification of the *prima facie* measure in order to achieve the objective of damages stated in *Robinson* or to avoid overcompensating the buyer. Special circumstances exist where the *prima facie* measure fails to place the buyer in the position he would have occupied had the goods been in conformity with the contract.[99] In other words, the *prima facie* measure should be displaced where its application does not comply with the principle of *Robinson v. Harman.*[100] This may be the case where the application of the *prima facie* measure overcompensates or undercompensates the buyer.[101] Here, special circumstances restore the assessment of damages to the basic rules under Sections 53(2) of the SGA and 2-714(1) of the UCC.[102] Under these rules, the court is to elect the most appropriate measure of damages. The following will deal with cases where the *prima facie* measure is modified or displaced under special circumstances.

3.4.1 Modification of the *Prima Facie* Measure in order to achieve the objective of Damages as stated in *Robinson*

As the measure of damages stated in the SGA and the UCC is *prima facie,* the court may modify its application by applying it at other than the time of delivery or acceptance.[103] Cases, where the *prima facie* measure should be modified in order to comply with the principle of *Robinson v. Harman,*[104] seem hard to be put in an exhaustive list. In answering the following questions, one may deal with some of these circumstances. Where the defect cannot be discovered, or become certain,[105] before using the goods, can the diminution in value of the defective goods be measured at the time of discovery of the defect? Further, in cases where the buyer has passed the goods to a sub-buyer without examining them and the seller was aware of the subsale at the

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Uniform Commercial Code. The reference mentioned is concerned with chapter two of the Texas Business and Commerce Code which corresponds to Article two of the official Uniform Commercial Code.

[98] Special circumstances in this context are different from those stated in the rule of *Hadley v. Baxendale* [1854] 9 Exch.341. The former is the circumstances which displace or modify the *prima facie* measure for the purpose of quantifying damages for diminution in value while the latter is the circumstances which should be known to both parties in order to award consequential damages for loss caused by the breach under such circumstances.

[99] R.R.Anderson, supra n.72 at p.322; Uniform Commercial Code Permanent Editorial Board, 1 *PEB Study Group Uniform Commercial Code Article 2: Preliminary Report, American Law Institute*, 1990, 36.

[100] (1848) 1 Exch 850, 855. Supra, p.1.

[101] See Chad A. Cicconi, supra n.48.

[102] Supra, p.50.

[103] The time at which damages are calculated under the *prima facie* measure is the time of delivery under the SGA and the time of acceptance under the UCC.

[104] (1848) 1 Exch 850, 855. Supra, p.1.

[105] See *Vreeman v. Davis*, 1984 Minn. LEXIS 1356; 348 N.W.2d 756 (1984).

time of making the contract, can the diminution in value be measured at the time of arrival of the goods to their destination? Finally, where the seller causes a delay in the resale of the defective goods, can the diminution in value be measured at the time of resale?

The application of the *prima facie* measure assumes that the buyer could immediately resell the defective goods in the market if the goods are valued at the market price.[106] The buyer will not have the chance to do so before discovering the defect of the goods. Therefore, where the defect is of a nature which cannot be discovered before using the goods, it seems reasonable to measure the difference in value at the time of discovery of the defect. Furthermore, in order to consider the actual position that the buyer is placed in due to the breach, the defective goods should be valued at the time when the defect is discovered. In other words, the goods should be valued at the time of discovery of their defect in order to achieve the objective of damages stated in *Robinson.*

The UCC case of *Adam Metal Supply, Inc. v. Electrode, Inc.*,[107] seems a good example. In this case, the buyer bought aluminium sheeting of a specific kind. After it had been sheared, it appeared to be of a different kind from that contracted for. It was decided that this case was one of special circumstances since it was necessary to shear the aluminium in order to determine that it was not as warranted. Due to that, the court decided that the value of the aluminium accepted should be ascertained after it was sheared.[108]

It is worth noting that the warranty might relate to the future, e.g. the sale of seeds. In this example the buyer will not be able to discover the defect until the crops appear defective. In cases of defective seeds, the buyer would normally be entitled to the difference between the actual value of crops and the value they would have had but for the defective seeds.[109] In such a case, the diminution in value of the crops is a kind of consequential loss since it results from the use of the defective goods purchased. Here, the normal loss is the diminution in value of the defective seeds themselves at the time

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[106] A.G. Guest, supra n.22 at p.936.
[107] 1980 Fla. App. LEXIS 17088; 30 UCC Rep. Serv. 178 (1980).
[108] *Adam Metal Supply, Inc. v. Electrode, Inc.* 1980 Fla. App. LEXIS 17088; 30 UCC Rep. Serv. 178 (1980). In this case the Court held that "the 'special circumstances' of this case, namely the fact that it was necessary to shear the aluminum in order to determine that it was Coilzak [as warranted], mandates that [the value of the aluminum accepted be ascertained after it was sheared] and makes it perfectly proper under section [2-714]."
[109] S. M. Waddams, supra n.27 at p.158.

of delivery. However, by awarding the buyer damages for the diminution in value of the crops, the buyer would be put, so far as money can do it, in the same position he would have been in had the seeds been defect free. The buyer in such a case should not be entitled to recover for the diminution in value of the seeds jointly with damages for the diminution in value of the crops. By awarding the buyer damages for the diminution in value of the seeds, the buyer would be overcompensated. This is one of the cases, discussed below,[110] where damages cannot be awarded for both normal and consequential losses.

Where goods are bought for resale, they may be valued at the time of their delivery to the sub-buyer. In applying the principle of *Robinson*, one should consider the economic end-result of delivering conforming goods. If the goods are discovered to be defective at the time they were delivered to sub-buyer, the buyer's liability to the sub-buyer may be for the diminution in value of the goods measured at that time. Therefore, it is more realistic to apply the *prima facie* measure at the time when the goods are delivered to the sub-buyer provided that the seller was, or should have been, aware at the time of making the contract of the fact that the goods would be resold. The case of *Van Den Hurk v. R. Martens & Co. Ltd.,*[111] seems to be helpful. In this case, the buyer purchased a quantity of sodium sulphide. The sellers admitted that they had been informed by the buyer that the goods were required for export and were not for home trade.[112] The sub-buyers rejected the goods on the ground that they were of an inferior quality of caustic soda. In this case, the Court held that the damages were to be assessed "according to the prices ruling at the date when they arrived to their ultimate destination".[113] This case states an important rule in cases of resale transactions. Where the seller is aware, at the time of making the contract, that the buyer will deliver the goods to a third party without examining them, damages will be measured according to the value of the goods at the time of their arrival to the ultimate buyer. Nevertheless, damages may be calculated at a later date where the defect of the goods cannot be known by the time of their use as discussed in the previous paragraph.

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[110] Infra, p.91..
[111] [1920] 1 KB 850.
[112] Ibid at p.851.
[113] Ibid at p.853.

Since the *prima facie* measure presumes that the buyer may resell the defective goods and obtain a substitute, the time of determining the value may be decided to be the time of resale. This may be quite obvious in cases where the resale is delayed due to the seller's negotiations with the buyer. In *Loder v. Kekule,*[114] the price of the resale of the defective goods was considered as the value of the defective goods since the seller had delayed the resale by his negotiations with the buyer. In this view, it can be noted that where, due to the seller's negotiations with the buyer, the resale of the defective goods is delayed, the court may consider the resale price as the value of the defective goods for the purpose of the application of the *prima facie* measure.[115]

In any case, where the buyer has mitigated his normal loss, i.e. the diminution in value, the court may be reluctant to award the buyer more than his *actual loss*. In such a case, the court will be likely to displace the *prima facie* measure in order to award the buyer damages for his loss as mitigated.[116] The buyer may mitigate his loss by reselling the defective goods at a price higher than the market price. However, whether such a resale price can be considered for calculating the buyer's damages is a controversial point as discussed below.[117]

3.4.2 Displacement of the *Prima Facie* Measure where it does not Comply with the Principle of *Robinson*

In certain cases, the application of the *prima facie* measure may not be appropriate to achieve the objective of damages stated in *Robinson v. Harman.*[118] However, in other cases, applying the principle of *Robinson* may undercompensate the buyer. This can be the case of "betterment", as explained below. Therefore, alternative measures should be considered in order to avoid overcompensating or undercompensating the buyer. The commonest example of such measures is the cost of cure as discussed below.[119] Displacement of the *prima facie* measure occurs normally where such a measure fails to apply or where it awards the buyer more or less than his actual loss.

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[114] (1857) 3 C.B. 128, 140.
[115] A.G. Guest, supra n.22 at p.936.
[116] See *Vorthman v. Keith E. Myers Enterprises,* 1980 Iowa Sup. LEXIS 923; 30 UCC Rep. Serv. 924 (1980).
[117] Infra, p.95.
[118] (1848) 1 Exch 850, 855. Supra, p.1.
[119] Infra, p.77.

The buyer may suffer normal loss, i.e. diminution in value of the goods supplied, and consequential losses resulting from the breach of warranty of quality. Where it is possible to calculate the buyer's loss without the need to distinguish between normal and consequential losses, should the court draw such a distinction? As damages are a question of fact, the court may not need to draw a distinction between normal and consequential losses in cases where there is no exclusion or limitation of the seller's liability. This may be helpful in cases where it is hard to draw such a distinction. Here, the UCC case of *Holm v. Hansen*[120] seems to be illustrative. In this case the buyer purchased a herd of cattle. Within a period after acceptance, the buyer discovered that some of the cows were diseased. The disease was contagious. Consequently, all the cows were infected. The court found that it is impossible to ascertain which of the purchased cattle have been carrying the disease at the time of purchase. Upon that, the court decided that "this is a proper case for application of the exception in [Section 2-714(1)], which is to be used when special circumstances show proximate damages of a different amount."[121] Consequently, it was held that the buyer "is entitled to fair and reasonable compensation for the loss he sustained to his entire herd as the proximate result of defendant's breaches of warranty."[122] In this case it is obvious that part of the buyer's loss was consequential since it was unlikely that all the cows were infected at the time of acceptance. It was hard, however, to identify the borderline between normal and consequential losses. Therefore, displacing the *prima facie* measure was necessary to award the buyer damages for his actual loss.[123] Nevertheless, in such a case, if the seller had limited or excluded his liability for consequential losses, the court might have found it necessary to find a way to estimate the consequential loss of the buyer in order to exclude it from the seller's liability. As mentioned in chapter one, the classification of normal and consequential losses adopted in this thesis does not apply in the context of contractual exclusions from liability.[124]

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[120] 1976 Iowa Sup. LEXIS 1065; 248 N.W.2d 503 (1976).
[121] Ibid, p.19, p.510 respectively.
[122] Ibid, p.20, p.510 respectively.
[123] The case of *Smith v. Green* (1875) 1 C.P.D. 92, provides a further illustration of the point. In this case, the plaintiff bought a cow from the defendant with a warranty that the cow was free from foot and mouth disease. The plaintiff who was a farmer placed the cow with other cows. The cow appeared to be diseased and some of the other cows were infected by the disease and died. In this case the court found that the seller knew, at the time of making the contract, that the buyer is a farmer and he would probably place the cow with other cows. On this ground, the court held that the defendant [seller] is liable in damages for the entire loss. In this case, the normal loss was the diminution in value of the purchased cow while the consequential loss was the diminution in value of the other diseased cows. However, there was no need to draw the distinction between these two losses.
[124] Supra, p.6.

3.4.2.1 Cost of Cure

The concept 'cost of cure' plays several roles in assessing damages for defective quality. Cost of cure of the defective goods can be evidence of the difference in value damages. It can also be a separate measure of damages, which displaces the *prima facie* measure in order to allow damages that comply with the principle of *Robinson v. Harman.*[125] Furthermore, cost of cure can be claimed, jointly with damages for diminution in value, as a kind of consequential loss in cases where the defective goods cause damage to other property. The following will deal with each role separately.

A) Cost of Cure as an Evidence of the Diminution in Value

Where the buyer's damages can be measured by the *prima facie* measure, cost of cure may be considered as evidence of the diminution in value. In such cases, the application of the *prima facie* measure complies with the principle of *Robinson.* Cases show that cost of cure can be strong evidence of the difference between the value of the goods as warranted and their value as accepted.

For example, in *Minister Trust, Ltd. v. Traps Tractors, Ltd., and Others,*[126] the Court awarded damages for breach of warranty. The Court held that "the measure of damages was the difference between the value of the machines [the subject of the contract] fully re-conditioned in accordance with the contract and their value as delivered, and, as the market value could not be determined, the amount of the damages should be assessed by reference to the time... and cost of putting the machines into the contractual condition."[127] Likewise, in the UCC case of *Nelson v. Logan Motor Sales, Inc.,*[128] the Court held that the cost of repair could be used as evidence for the difference in

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[125] (1848) 1 Exch 850, 855. Supra, p.1.
[126] [1954] 3 All ER 136.
[127] Ibid at p.154-6. See also *Jackson v Chrysler Acceptances Ltd* [1978] *RTR* 474 where damages were claimed for breach of warranty of quality of a car. The court awarded the difference in value of the car at the time of delivery and took full account of the fact that various serious defective parts of the car had been replaced by the dealers.
[128] 1988 W. Va. LEXIS 84; 7 UCC Rep. Serv. 2d 116 (1988). In *Winchester v. McCulloch Bros. Garage,* 1980 Ala. LEXIS 3225; 30 UCC Rep. Serv. 212 (1980) it was held that where the goods are repairable, cost to repair is a useful measure of the difference in value. See also *Custom Automated Machinery v. Penda Corporation,* 1982 U.S. Dis. LEXIS 10875; 33 UCC Rep. Serv. 856 (1982) where the Court decided that the difference in value can be computed by reference to the costs of repairing the goods.

value.[129] These cases made it clear that the cost of cure may represent the difference in value.

The cost of cure can provide strong evidence of the difference in value if it restores the defective goods to the position they would have been in if they had been free from defects. In Soo *Line Railroad Co. v. Fruehauf*,[130] the Court held that "[i]f you find that the repair of the cars restored the cars to substantially the same conditions as they would have been in if properly manufactured, the difference or diminution in value is the same as the reasonable cost of repairing the cars...".[131]

In considering the cost of cure as evidence of the diminution in value, the court should avoid overcompensating the buyer. Clearly, where the cost of cure is evidence of the diminution of the value of the goods, the buyer should not be entitled to both the cost of cure and the diminution in value. Although this point seems to be clear, in one UCC case the court did award damages for both the diminution in value and cost of cure of the same goods and, consequently, the buyer was overcompensated. This was the case of *R. Clinton Construction Co. v. Bryant & Reaves, Inc.,*[132] where the Court awarded the buyer damages consisting of the reasonable cost of repair of the defective machinery and of the loss of income to the buyer during the down-time occasioned by the period of repairs. The Court also awarded the buyer damages for the difference between the value of the machinery as warranted and its value as received. It seems that the buyer in this case was overcompensated. Whereas the loss of income represents the consequential loss, the cost of repair represents the normal loss of the buyer, i.e. the diminution in value. In other words, the difference between the values of the machinery as warranted and as received was measured by the cost of repair which was recovered under the first head of the award. By allowing the buyer the difference in value and the cost of cure, the buyer received double recovery for the same loss, i.e. the diminution in value.

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[129] See the UCC cases of *Holden Mach. v. Sundance Tractor & Mower (In re Fried Group)* 1998 Bankr. LEXIS 193; 36 UCC Rep. Serv. 2d 709 (1998); *Winchester v. McCulloch Bros. Garage, Inc.,* [1980] Ala. LEXIS 3225; 30 UCC Rep. Serv. 212 (1998).

[130] 547 F.2d 1365 (8th Cir. 1977).

[131] Ibid, p.1378.

[132] 1977 U.S. Dist. LEXIS 12222; 23 UCC Rep. Serv. 310 (1977). Cited in M.T. Gibson, 'Reliance Damages in the Law of Sales under Article 2 of the Uniform Commercial Code' (1997) 29 *Ariz. St. L.J.,* 909, n.432.

B) Cost of Cure as a Measure of Damages: Does it Comply with the Principle of *Robinson*?

The buyer should not be entitled to damages for more than his actual loss. Where the cost of cure exceeds or is less than the diminution in value, on which basis can the buyer's damages be quantified? In answering this question, one needs to determine the actual loss of the buyer. The cost of cure may exceed the diminution in value in certain cases, such as the case where the goods in question are "secondhand". In this case, repairing such goods might put them in a better position than they would have been in if they had been as warranted.[133] The question here is whether the buyer is entitled to the cost of cure regardless of the "betterment".

Before considering this question, one may need to deal with the issue of whether the cost of cure can be generally recovered. The question has to be answered in view of the principle of *Robinson v. Harman.*[134] Under the principle of *Robinson,* one may answer the question in the positive as the recovery of the cost of cure would put the buyer in the position he would have been in if the goods had been delivered as warranted. However, under the mitigation principle, the buyer should not be entitled to recover for losses which he could have reasonably avoided. Therefore, where substitute goods are obtainable, the buyer will be expected to resell the defective goods and purchase goods of the right quality. If this becomes the case, the buyer's loss is the difference in the market value of the goods as warranted and as defective. Therefore, in such a case, the buyer may not be entitled to recover the cost of cure that exceeds the difference in value. Under the UCC, this has been decided in the leading case of *Line Railroad Co. v. Fruehauf.*[135] In this case, the United States Court of Appeals for the Eighth Circuit made it clear that

> "... if you find that the repairs of the cars placed the cars in a better condition than they would have been at the time of acceptance if they had been properly manufactured, then the difference or diminution in value recoverable by plaintiffs is the difference between the fair market value of the covered hopper cars as accepted by [the buyer] and the fair market value they would have had if

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[133] *Neuman v. Spector Wrecking & Salvage Co*mpany, Inc., 1973 Tex. App. LEXIS 2367; 12 UCC Rep. Serv. 254 (1973). This was a case of breach of warranty of quality of used goods. It was held eventually that awarding the buyer the cost of repair would put him in a better position than he would have occupied if the goods had been in conformity with the contract.

[134] (1848) 1 Exch 850, 855. Supra, p.1.

[135] 547 F.2d 1365 (8th Cir. 1977).

> [the seller] had manufactured them properly. So [the buyer] in this situation would not be able to recover the full amount spent for repairs."[136]

Exceptionally, the buyer may be entitled to recover, as damages, the cost of cure which exceeds the difference in value.[137] This may be the case where the breach of warranty of quality gives rise to a loss of 'consumer surplus'.[138] Under the remoteness principle,[139] such a loss should be in the reasonable contemplation of the parties, at the time of making the contract, as not unlikely to result from the breach. Where substitute goods are unobtainable,[140] such as unique goods, the seller is expected to know, at the time of making the contract, that the buyer will have no choice other than repairing the defective goods.[141]

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[136] Soo *Line Railroad Co. v. Fruehauf,* 547 F.2d 1365, p.1378 (8th Cir. 1977). It was decided that "the total figure cannot exceed the difference between the fair market value as accepted, and the fair market value in the defective condition you find".

[137] Under the UCC, this has been decided in *City of New York v. Pullman, Inc.*, 1981 U.S. App. LEXIS 10957; 31 UCC Rep. Serv. 1375 (1981), where the United States Court of Appeals for the Second Circuit held that "where special circumstances justify the use of a measure of damages other than that expressly provided by the statute, plaintiff may recover for its direct damages in any manner that is reasonable". An appropriate measure of damages under that provision is the "actual cost" of a remedy that meets the ultimate requirements of the contract by converting non-conforming goods into goods which will perform as warranted...". See also the UCC case of *Black v. Don Schmid Motor, Inc.,* 1983 Kan. LEXIS 228; 35 UCC Rep. Serv. 448 (1983) where it was held that the cost of repairs, necessary to bring the mobile home to conformity with the warranties of sale, is a sufficient measure of damages under section 2-714 (2) of the UCC.

[138] In *Watts v. Morrow* [1991] 4 All ER 937, where there was a breach of a contract for survey, the Court of Appeal held that cost of cure could be awarded where there is a breach of warranty of the condition of the house. In this case, the buyer was not allowed for more than the diminution in value since such a warranty did not exist. The surveyor was in breach of his duty to use proper care and skill in reporting upon the condition of the house. See also *O'Grady v. Westminster Scaffolding, Ltd.* [1962] 2 Lloyd's Rep. 238 where the plaintiff was allowed damages calculated on the basis of cost of cure although such a cost exceeded the difference in value. In this case, the plaintiff brought a suit in tort to recover for damage caused to the car by the defendant's negligence. The plaintiff has acted reasonably in repairing the car on the ground that the car was considered as unique and the plaintiff was emotionally attached to the car.

[139] Infra, p.284.

[140] As concerns secondhand goods, Professor Anderson states that it is generally understood that the measure of damages is the cost of repair when repair is possible. Ronald A. Anderson, *Anderson on the Uniform Commercial Code,* New York, 3rd ed., 1997, p.444. However, in cases where a substitute car is available, the buyer should mitigate his loss by obtaining a substitute car. For example, in *Darbishire v. Warren* [1963] 1 WLR 1067 where the plaintiff purchased a secondhand car, which appeared defective, the Court of Appeal made it clear that the measure of damages in the case of a replaceable chattel such as a secondhand car is the difference in market value. The Court held that the plaintiff, who was under a duty to mitigate the loss, had had the car repaired at a cost exceeding its market value instead of trying to replace it with a comparable car at the market price. The plaintiff had not acted reasonably vis-à-vis the defendant and was not therefore entitled to recover the cost of the repairs.

[141] See the UCC case of *Gem Jewelers, Inc., v. Dykman* 1990 N.Y. App. Div. LEXIS 3817; 12 UCC Rep. Serv. 2d 721 (1990) where the plaintiff contracted with defendant for the construction and installation of new, custom-designed jewellery cabinets, cases and fixtures for plaintiff's retail jewellery store. The goods installed were defective. The Supreme Court of New York held that "as this case can be found to involve goods not bought and sold on the open market, it can reasonably be concluded that the standard breach of warranty measure of damages under Section 2-714(2) [the *prima facie* measure] was inadequate. The plaintiff was allowed the cost of cure which exceeded the diminution in value.

In this sense, the buyer may be entitled to recover the cost of cure in such cases if the cure is the only way to deal with the breach of contract.[142] Indeed, whether in commercial or consumer contracts, if the only way to deal with defect is by cure, allowing the buyer the cost of cure will achieve the objective of damages stated in *Robinson v. Harman.*[143] The buyer will not be overcompensated since he will be awarded for his actual loss which could not reasonably be avoided. This may be the case where substitute goods are unobtainable. In fact, it is possible to envisage cases where the buyer may mitigate his loss by curing the defective goods even though such a cure costs more than the diminution in value. For example, suppose that the buyer bought machines specially manufactured to be used in his factory. In such a case, substitute goods are hard to be found. If the machine appears defective, the buyer may suffer loss of profit resulting from the loss of using the machine. The buyer may mitigate his loss of profit by curing the machine. In such a case, the mitigation principle[144] may apply to allow the buyer the cost of cure even though such a cost exceeds the diminution in value.

Where it is unreasonable for the buyer to cure the defective goods, can the cost of cure, which exceeds the diminution in value, be recovered? Under the principle of *Robinson*, the buyer may be entitled to recover such a cost of cure since by such a recovery he will be placed in the same position as if the goods had been in conformity with the contract. However, where it is unreasonable to cure the defective goods, it becomes unfair to allow the buyer damages calculated on the basis of cost of cure. English law imposes the restriction of reasonableness on the recoverability of the cost of cure. Under such a restriction, it should be reasonable for the buyer to cure the defect. The restriction of reasonableness was considered by the House of Lords in *Ruxley Electronics and Construction Ltd. and another v. Forsyth.*[145] The case involved a contract of construction of swimming pool. The construction did not conform to the contract. The

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[142] Orsborn suggests that under the consumer surplus theory the buyer may not be entitled to recover the cost of cure, which exceeds the diminution in value, in cases where the contract is entered into as a means of financial gain. Justin Orsborn, 'Expectation Damages for Breach of Contract and the Principle of *Restitutio In Integram'* [1993] *Auckland U. L. R.* 305, 329.

[143] (1848) 1 Exch 850, 855. Supra, p.1.

[144] Infra, p.298.

[145] [1996] 1 AC 344. The case is of construction contract but the principle of reasonableness, considered in the case, applies similarly to sale of goods cases. It may be unreasonable for the buyer to repair the goods if the cost of repair is more than the diminution in value and substitute goods are available. In such a case, the buyer may resell the defective goods and obtain substitute. However, the buyer may be entitled to the cost of cure, which exceeds the diminution in value, where substitute goods are not available or there is a 'consumer surplus'.

plaintiffs sued the defendant who was the owner of the pool for the balance of the agreed contract sums. The defendant counterclaimed damages for the breach of contract on the ground that the depth of the pool was less than the agreed depth stated in the contract. At first instance, it was found that there was no sufficient evidence to prove that the shortfall in the depth had decreased the value of the pool and the Court of Appeal did not find materials to fault that conclusion. The Court of Appeal held that the defendant was entitled to the cost of the remedial work. However, this award was rejected by the House of Lords[146] on the grounds that it would be unreasonable for the owner to incur the cost of demolishing the existing pool and the cost of constructing a new and deeper one.[147]

Arguably, the reasonableness restriction, considered in *Ruxley,* is not an application of the mitigation principle.[148] Under the mitigation principle, the buyer is not entitled to recover, as damages, the expenses he incurred on unreasonable steps to mitigate his loss. Here, one may argue that where it is unreasonable for the buyer to cure the defect, the mitigation principle will apply to prevent the recovery of damages for the cost of such a cure which exceeds the diminution in the market value. However, where there is no substitute, it is hard to say that cost of cure is an avoidable loss. In a case such as *Ruxley*, the mitigation principle cannot restrict the owner's claim to recover the cost of cure since in pursuing reinstatement, the owner is taking the *only* available step to cure the nonconforming construction.[149] It is hard to accept that the buyer fails to mitigate his loss by curing the defect where such a cure is the only way to deal with the defect. The mitigation principle can apply here to limit the recovery to the reasonable cost of cure in the sense that the buyer should not choose to remedy the defect by an expensive way where a cheaper way is available.[150] Regardless, it was decided that the cost of cure was unrecoverable since it was unreasonable to cure the defective swimming pool. It is submitted that the reasonableness restriction, considered in *Ruxley,* is not an application of the principle of mitigation and it is a separate restriction imposed upon the recovery of damages calculated on the basis of cost of cure. Nevertheless, it should be noted that

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[146] [1996] 1 AC 344.
[147] See Roger Halson, 'Damages, Diminution in Value and Cost of Cure' [1995] *LMCLQ* 27.
[148] In contrast, see Jill Poole, 'Damages for Breach of Contract - Compensation and Personal Preferences: *Ruxley Electronics and construction Ltd v Forsyth*' (1996) 59 *MLR* 272, 276 where the writer suggests that the reasonableness requirement in the case of *Ruxley* "referred only to the issue of mitigation". See Duncan Miller, Damages for Defective Works: Reasonableness and Restitution, [1995] *Building and Construction Law* 379, 386-7.
[149] Alexander F H Loke, supra n.39 at p.195.

issue of whether the reasonableness restriction is an application of the mitigation doctrine or a separate restriction is a theoretical matter which should not affect the recoverability of damages. This is because the buyer would not be entitled, in any case, to recover the cost of cure where it was *unreasonable* to cure the defect.

Where the cure is unreasonable, the buyer may not be expected to cure the defect. In this sense, the restriction of reasonableness may help to avoid overcompensating the buyer. This seems to be a significant point in quantifying the buyer's damages in order to strike the right balance by achieving, so far as possible, the objective of damages, as stated in *Robinson v. Harman,*[151] and ensuring that the buyer is not overcompensated. The restriction of reasonableness seems to be of vital significance to the recoverability of the cost of cure. It is absolutely logical that damages should not be quantified on the basis of the cost of cure where the diminution in value is quite trivial. Generally, awarding the buyer the cost of cure, where it is unreasonable for him to cure the defective goods, may result in the so-called economic waste.[152] The restriction of reasonableness should be considered with the other restrictions[153] imposed on the recovery of damages in cases where the buyer claims the cost of cure.

Deciding what is reasonable is a matter of fact which depends on the circumstances of each case. For example, the buyer may not be entitled to recover the cost of cure which is highly disproportionate to the difference in value. "In commercial context a plaintiff would not recover damages on a "cost of cure" basis if that cost was disproportionate to the financial consequences of the deficiency."[154] Under American law, Section 348(2) of the Restatement Second of Contracts provides that the plaintiff may recover, as damages, the "reasonable cost of completing performance or of remedying the defect if that cost is not clearly disproportionate to the probable loss in value to him". The leading case in this respect is *Jacob Youngs v. Kent*[155] where it was held that the

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[150] For the mitigation principle, see infra p.298.
[151] (1848) 1 Exch 850, 855. Supra, p.1.
[152] Timothy J. Muris, supra n.36 at p.391.
[153] See chapter seven at p.277.
[154] *Channel Island Ferries Ltd. v. Cenargo Navigation Ltd* (*The Rozel*) [1994] 2 Lloyd's Rep. 161, 168. (Charterparty) In this case, the owners of the ship in question were not entitled to recover, as damages, the cost of cure on the ground that the cost was grossly disproportionate to the difference in value. The charterers were not liable for the diminution in value since there was no ample evidence of the difference in value.
[155] [1921] 129 NE 889 cited in Alexander F H Loke, supra n.39 at p.194. See the decision of the United States Court of Appeals for the Eighth Circuit in *R. W. Murray Co. v. Shatterproof Glass Corp.* 1985 U.S. App. LEXIS 29814; 40 UCC Rep. Serv. 1283 (8th Cir. 1985). In this case, the buyer bought

plaintiff was entitled to recover the cost of cure unless such a cost is *grossly and unfairly* out of proportion to the good to be attained. Nonetheless, the court may take into consideration other factors in applying the restriction of reasonableness. For example, in consumer contracts, where the seller is aware at the time of making the contract that the goods are of more subjective value to the buyer than their market value, the court may be inclined to award the buyer the cost of cure although it exceeds the diminution in value. Certainly, "contract law should protect a person's subjective choices and eccentric tastes."[156]

Moreover, the House of Lords in *Ruxley* did not ignore the plaintiff's consumer Surplus. Damages were awarded for loss of amenity. This seems to be a convenient approach of the issue since the aggrieved party, by such an approach, was compensated for his actual loss. In *Ruxley,* the nature of the contract made it clear that loss of amenity was in the contemplation of the parties at the time of making the contract as not unlikely to result from the breach. As explained above,[157] in order to be considered in quantifying the buyer's damages, the 'subjective value' or 'consumer surplus' should be in the reasonable contemplation of the parties at the time of making the contract. Therefore, in principle, damages for loss of 'consumer surplus' can be awarded in any case, whether consumer or commercial, under the normal restrictions imposed on the recovery of damages. However, 'consumer surplus' is unlikely to arise in commercial cases. In normal circumstances, businessmen are normally concerned with their financial loss caused by the seller's breach. Therefore, whether or not the commercial buyer can recover for loss of 'consumer surplus' depends on the purpose of purchasing the goods. In other words, the question turns to be whether the buyer can prove that he suffered loss of 'consumer surplus'.

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reflective glass panels to use them for installation in a four-storey office building in order to fulfil his contractual obligation to the owner of the building. The panels proved defective. The buyer and the owner of the building (plaintiffs) submitted that the piecemeal replacement of defective glass panels would not cure the defect. Their experts testified that complete replacement of all the panels was necessary. The case was considered as one of special circumstances where the *prima facie* measure of damages could be displaced. The *prima facie* measure was displaced in order to award the buyer the cost of replacement which exceeded the diminution in value of the panels. The Court stated that "[t]his measure of damages [the cost of replacement] was appropriate here, as [the buyer] suffered damages which could only be remedied by replacement of the panels. As such, the special circumstances [in this case] show [that the buyer] suffered proximate damages of a different amount than that which is ordinarily recoverable for breach of warranty. The jury's award of the replacement cost of the panels merely compensated [the buyer] for the proximate damages it actually suffered by reason of [the seller's] breach of warranty." See also *Western Paper Co. v. Bilby,* 1989 Okla. Civ. App. LEXIS 52; 11 UCC Rep. Serv. 2d 503 (1989).

[156] Gerard McMeel, 'Common Sense on Cost of Cure' [1996] *LMCLQ* 456, 458.

[157] Supra, p.55.

It seems unclear whether the restriction of reasonableness, considered in *Ruxley,* applies under the CISG. However, it is unlikely for the court to award damages for the cost of cure where it is unreasonable for the buyer to cure the defective goods. Here, there is nothing to prevent the court from awarding damages for loss of amenity where the cost of cure appears an inappropriate measure. This was, as previously mentioned, the case in *Ruxley* where the House of Lords entitled the buyer to damages for loss of amenity.[158] However, as explained in the previous paragraph, loss of amenity is unlikely to be suffered in commercial contracts. Since the CISG is unlikely to apply to consumer cases, damages for loss of amenity may not be claimed under the Convention.

As the previous discussion dealt with the recoverability of damages based on the cost of cure where such a cost exceeds the diminution in value, further discussion should be directed to the case where the cost of cure is less than the diminution in value. It is likely that the buyer will seek to recover the difference in the value of the goods as warranted and as received wherever the cost of cure is less than such a difference in value. The question here is whether the difference in value is recoverable in such a case. Certainly, the answer to this question depends on whether or not the cure restores the goods to their condition as warranted by the contract.

In answering this question, one should mainly look at the actual loss suffered by the buyer. Where the cure does not restore the goods to the same condition they would have been in if they had been in conformity with the contract, the buyer may be entitled to the cost of cure plus the difference between the value of the goods as warranted and such a cost. Such an award seems to achieve the objective of compensatory damages stated in *Robinson v. Harman.*[159] By such an award, the buyer would be put in the position as if the goods had been delivered as warranted.

Under the UCC, this was stated clearly in the aforementioned case of *Soo Line Railroad,*[160] where the United States Court of Appeals for the Eighth Circuit held that

> "...if you find that the repair of the cars did not restore them to substantially the same condition as if they would have been if properly manufactured, then *the difference or diminution in value is the reasonable cost of repair, plus the*

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[158] *Ruxley Electronics and Construction Ltd. and another v. Forsyth,* [1996] 1 AC 344, 373-4.
[159] (1848) 1 Exch 850, 855. Supra, p.1.
[160] Soo *Line Railroad Co. v. Fruehauf,* 547 F.2d 1365 (8th Cir. 1977).

difference between the fair market value of the covered hopper cars if they had been manufactured without faults or defects, and the fair market value of the repairs..."[161] [Emphasis added]

However, the principle of *Robinson* should be applied jointly with the mitigation principle in cases where the cure brings the defective goods to the contract standard and costs less than the difference in value. In such a case, the difference between the cost of cure and the difference in value may be considered as a mitigated loss. The question of whether or not the buyer was required, under the mitigation principle, to mitigate his loss by curing the defect is of no relevance. This is because the mitigation principle does not allow the buyer damages for losses which have been avoided in fact.[162] By awarding the buyer the difference in value in such a case, the court will ignore the application of the mitigation principle which is one of the restrictions imposed on the recovery of damages. Therefore, the court will be likely to displace the *prima facie* measure by awarding the buyer the cost of cure. For example, in the UCC case of *Tarter v. Monark Boat Co.*,[163] the buyer was awarded the cost of cure ($37,000) which was much less than the difference between the value of the goods as warranted and as accepted ($100,000). Such a displacement of the *prima facie* measure is necessary in order to compensate the buyer for the loss he suffers in fact and to avoid overcompensation. This is one of the cases where the cost of cure is considered as a measure of damages and not as evidence of the difference in value.[164] Certainly, in such cases, the cost of cure may fix an upper limit for recovery.[165]

C) Cost of Cure as Consequential Loss

The use of defective goods may result in physical damage to property other than the goods purchased. In such a case, the buyer may reinstate such property and seek to recover the cost from the seller. Where the cost of reinstatement equals the difference between the pre-damage value of the property and their value as damaged, the buyer may use the cost of cure as evidence of the loss he suffered. However, the issue becomes complicated where the cost of cure exceeds or is less than the difference in value. The above discussion dealt with this issue in respect of the repair of defective goods

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[161] Ibid, p.1378.
[162] For the mitigation principle, see infra p.298..
[163] 1977 U.S. Dist. LEXIS 16015; 22 UCC Rep. Serv. 33 (1977).
[164] This issue has not been discussed by the English court. See M P Furmston 'damages- diminution in value or cost of repair?- damages for distress' (1993) 6 *JCL* 64, 65.

purchased. It is submitted that the same results reached in that respect would apply to the case where damage was caused to property other than the goods purchased.

Now we turn to the question of whether the buyer is entitled to recover the cost of cure regardless of the improvement resulting from the cure. Cure may put the goods in a better position than they were before the damage. This is commonly called the issue of betterment. At first sight, answering this question in the positive seems to be in direct contradiction with the objective of damages stated in *Robinson v. Harman.*[166] By allowing the buyer such a cost of cure, he will be put in a *better* position than he would have been in if the goods had been delivered as warranted. But, what would be the case, if the only way to deal with the breach is by curing the defect of the goods? In such a case, would the buyer be overcompensated if he were awarded the cost of cure?

The famous case of *Harbutt's Plasticine Ltd. v. Wayne Tank and Pump Co. Ltd.*,[167] seems to be helpful. In this case, the defendant agreed to design, build and install a heated pipeline and tank system for use in the plaintiff's factory. Due to defective performance by the defendant, the whole factory was destroyed by fire. The plaintiff lost the heated pipeline system and suffered damage to his factory. In this case the Court awarded the buyer the cost of reinstatement of his damaged property although the difference in value of the factory before and after the fire was less than the award. The decision in this case seems to be fair in light of the fact that the reinstatement of the factory was the only way to deal with the damage and the plaintiff could not reinstate the factory without 'betterment'. Widgery LJ said:

> "In my opinion each case depends on its own facts, it being remembered, first, that the purpose of the award of damages is to restore the plaintiff to his position before the loss occurred, and secondly, that the plaintiff must act reasonably to mitigate his loss. If the article damaged is a motor car of common make, the plaintiff cannot charge the defendant with the cost of repair when it is cheaper to buy a similar car on the market. On the other hand, if no substitute for the damaged article is available and no reasonable alternative can be provided, the plaintiff should be entitled to the cost of repair.... Nor do I accept that the plaintiff must give credit under the heading of "betterment" for the fact that their new factory is modern in design and materials. To do so would be the equivalent of forcing the plaintiffs to invest their money in the modernizing of their plant which might be highly inconvenient for them."[168]

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[165] E. Ellan Farnsworth, Legal Remedies for Breach of Contract, (1970) 70 *Colum. L. Rev.* 1145, 1169.
[166] (1848) 1 Exch 850, 855. Supra, p.1.
[167] [1970] 1 All ER 225.
[168] Ibid at p.240.

In the light of the above discussion, one may summarize the issue of betterment as follows. The buyer cannot, in certain cases, restore the defective goods to their position as warranted nor can he restore damaged interests to their pre-loss position without improvement (betterment).[169] In such a case, the cost of cure may exceed the damages recoverable under the principle of *Robinson v. Harman.*[170] However, in such a case, the buyer does not have any choice other than curing the defect. Moreover, the improvement will not increase the buyer's profit. The case should be different where the improvement increases the buyer's profit.[171] Therefore, the buyer will not be overcompensated by allowing him the cost of cure in cases where the only way to deal with the breach is by curing the defect and such a cure does not increase the buyer's profit. Therefore, in such cases, disallowing the cost of cure may undercompensate the buyer. In view of that, it seems that the case of *Harbutt's Plasticine* was rightly decided. Although the decision did not achieve the objective of damages, as stated in *Robinson,* the plaintiff was not overcompensated as he did not have any choice other than reinstating the building. Indeed, in this case, the defendant was held liable for the actual loss caused by his breach. This can be an exception to the objective of damages stated in *Robinson.* Here, it should be remembered that the recovery of the cost of cure is subject to the reasonableness restriction as discussed above.[172] In other words, it should be reasonable for the buyer to cure the goods. Where the defect is trivial and its cure costs much more than the difference in value, the buyer may not be entitled to the cost of cure. Therefore, in *Harbutt's Plasticine,* if it had been unreasonable to reinstate the building, the plaintiff would not have been entitled to the cost of cure.

3.4.2.2 Issues Concerning the Recoverability and Quantification of Damages in Cases of Cost of Cure

At the last point of the discussion regarding cases of cost of cure, one needs to deal with further questions that have certain effect on the recoverability and quantification of damages in such cases. Where the buyer cured the defect by himself, would he be entitled to recover damages for his out-of-pocket expenses plus a profit for his time and effort? Where the diminution in value resulted partly from the use of the goods, would

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[169] I.N. Duncan Wallace, *Hudson's Building and Engineering Contracts*, London, Vol.1, 11th ed., 1995, p.1050.
[170] (1848) 1 Exch 850, 855. Supra, p.1.
[171] Infra, pp.88-91.

the buyer be entitled to recover, as damages, the cost of cure? Is it necessary to cure the goods in order to consider the cost of such a cure as evidence of the difference in value or as a separate measure of damages? Where repair or replacement of profit-making goods or parts of them improves their productive capacity, should such improvement be taken into account in calculating the buyer's damages?

Where the buyer or his employees cured, or participated in curing, the defects, there would be no reason for not allowing him to recover damages for his out-of-pocket expense plus a profit for his time and effort. The buyer may recover, as damages, what he has reasonably spent for such a cure plus a profit for his time and effort.[173] This recovery can be simply understood on the ground that if the defects were cured by other contractors, the buyer would be entitled to recover what he had paid to them. Therefore, the seller should not benefit from depriving the buyer of a profit on work which was required reasonably for curing the defect.[174] By such a recovery, the buyer will be compensated for his actual loss and also the objective of damages, as stated in *Robinson v. Harman,*[175] will be achieved. Of course, such a recovery would be subject to the application of the normal restrictions imposed on the recovery of damages.[176]

The depreciation resulting from using the goods for a period of time should be considered in order to avoid overcompensating the buyer under the principle of *Robinson.* It should be remembered that the diminution in value is normally measured at the time of delivery. However, it has been mentioned that where the defect of the goods cannot be discovered before using the goods, the diminution of value may be measured at the time when the defect is or can be reasonably discovered. Probably, part of the diminution in value of the goods may result from their use. Therefore, the court may take into consideration the depreciation resulting from the use. In such a case, the buyer may not be entitled to recover, as damages, the cost of cure which may put the goods in the position they would have been in had the contract been properly performed.[177] The award here should be the cost of cure less an amount equaling the diminution in value

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[172] Supra, p.79.
[173] *Custom Austomated Mach. v. Penda Corporation,* 1982 U.S. Dist. LEXIS 10875; 33 UCC Rep. Serv. 856 (1982).
[174] R.R.Anderson, supra n.72 at p.340.
[175] (1848) 1 Exch 850, 855. Supra, p.1.
[176] Infra, p.277.
[177] See *Community Television Services, Inc. v. Dresser Industries, Inc.* 1977 U.S. Dist. LEXIS 14804; 22 UCC Rep. Serv. 686 (1977). See S. M. Waddams, supra n.27 at pp.152-3.

resulting from the use of the goods that the buyer had enjoyed over the period preceding the time of discovering the defect.[178] However, this may not be the case where the cost of cure is considered as a separate measure of damages, which displaces the *prima facie* measure. In such a case, the recoverability of the cost of cure would be subject to the discussion stated under the previous section.

The third question was best dealt with in *Ruxley*. It seems that where costs of cure are accepted as evidence of the difference in value, there is no requirement of curing the defect in fact.[179] More importantly, where it is reasonable to cure, there is no need for the buyer to show his intention that he will use the award for curing the defects.[180] Since the buyer will not be allowed the cost of cure where it is unreasonable to cure the goods, there seems no point of requiring the buyer to spend the award of damages on curing the defective goods. This point was made clear in *Ruxley*. Lord Jauncey, in *Ruxley*, made it clear that "the court has no concern with the use to which a plaintiff puts an award of damages for a loss which has been established."[181] However, Lord Jauncey continued to emphasize that "[i]ntention, or lack of it, to reinstate can have relevance only to reasonableness and hence to the extent of the loss which has been sustained."[182] In this sense, one may note that where the aggrieved party has started curing the defect or has already cured it, he may become in a good position to convince the court that it is reasonable to cure the defect.

As regards the last question, which deals with the superiority of substitute or cured goods, the following will argue that profits derived from such a superiority should be considered to reduce the buyer's damages in order to avoid overcompensating the buyer.

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[178] S. M. Waddams, supra n.27 at p.158.
[179] R.R. Anderson, supra n.72 at p.338. See also *Teledyne Indust. v. Patron Aviation, Inc.,* 1982 Ga. App. LEXIS 1951; 33 UCC Rep. Serv. 1365 (1982).
[180] See Gerard McMeel, supra n.156; Jill Poole, supra n.148.
[181] *Ruxley Electronics and Construction Ltd. and another v. Forsyth,* [1996] 1 AC 344, 359; see also the similar opinion of Lord Lloyd at p.364-5. The view was different in the past; "it has been said that the plaintiff is entitled to the reasonable cost of having the remedial work done if in all the circumstances it is (or was) reasonable for him to insist on having the work done-- and either (a) he has actually has the work done, or (b) he undertakes to have it done, or (c) he shows a "sufficient intention" to have the work done if he receives damages on this basis." D. Harris, A. Ogus, J. Phillips, 'Contract Remedies and Consumer Surplus' (1979) 95 *LQR* 582, 590.
[182] *Ruxley Electronics and Construction Ltd. and another v. Forsyth,* ibid at p.359. In this case Lord Lloyd, at p.372, said "I fully accept that the courts are not normally concerned with what a plaintiff does with his damages. But it does not follow that intention is not relevant to reasonableness, at least in those cases where the plaintiff where the plaintiff does not intend to reinstate." Intention to cure can be evidence that the aggrieved party has suffered a loss of 'consumer surplus'. See Elizabeth Macdonald, Breach of a Contractual Obligation: Cost of Cure or Market Value? (1988) 52 *Conv. & Prop. Law.* 421, 422.

Deciding otherwise will allow the buyer more damages than the damages he is entitled to recover under the principle of *Robinson.* In other words, by ignoring the extra profit gained by using the superior substitute, the court may fail to achieve the objective of damages stated in *Robinson* by placing the buyer in a better financial position than the position he would have been in if the goods had been free from defects. The case of *British Westinghouse Electric and Manufacturing Co. Ltd. v. Underground Electric Railways Co. of London Ltd*[183] seems to be helpful. In this case, a railway company purchased turbines which appeared defective. The buyer used the turbines for several years before he decided to replace them with other turbines of a different make and design. By the time the turbines were replaced, the buyer had incurred extra expenses on the excess of coal consumption. The substituted turbines were more efficient. The House of Lords held that "the pecuniary advantage which the railway company [the buyer] derived from the superiority of the substituted turbines was relevant matter for the consideration of the arbitrator in assessing the damages..."[184] Indeed, the court in calculating the buyer's damages should take into account the superiority of substitute goods. In order to achieve the objective of damages stated in *Robinson* and avoid overcompensating the buyer, it is submitted that damages in cases of replacement of defective goods can be quantified as follows:

([cost of replacement[185] + extra expenses incurred in using defective goods] – [the salvage value of the defective goods + extra profit derived from the superiority of the substitute goods])

In calculating damages in cases of replacement, one needs to take into account the commercial life of the substitute goods. Where the commercial life of the substitute

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[183] [1912] AC 673.
[184] Ibid at p.674.
[185] The cost of replacement includes expenses incurred in removing the defective goods and installing the new goods. For example, in the UCC case of *Rose v. Helm* 1972 Colo. App. LEXIS 885; 11 UCC Rep. Serv. 496 (1972) where the buyer of a restaurant business warranted that the equipment, which included a canopy, was in good operating condition, and the canopy collapsed approximately one year later because of its defective construction, the court held that the buyer could recover the costs incurred in replacing the collapsed canopy as consequential damages under Section 2-715. However, expenses incurred in installing new machine in connection with its superior design may not be recoverable. For example, in the UCC case of *Service Iron Foundry, Inc. v. M. A. Bell Co.,* 1978 Kan. App. LEXIS 219; 26 UCC Rep. Serv. 334 (1978) where the buyer of a defective pollution control device who was not permitted to recover the price of a more expensive replacement unit on the basis of special circumstances, was not entitled to recover the cost incurred in purchasing the more expensive unit, such as acquisition and installation costs and consulting engineer's fees in connection with designing the new unit though the buyer may be reimbursed for all expenses in installing and testing the faulty device.

goods is longer than the remaining of the supposed commercial life of the defective goods, could the court consider this point to reduce the buyer's damages provided that the replacement is reasonable? Likewise, where the cure extends the commercial life of the goods, could the court deduct the value of the extension from the recoverable cost of cure provided that the cure is reasonable? The question was raised in *Bacon v. Cooper (Metals) Ltd.*[186] The facts of this case can be summarized as follows. The fragmentiser, which was used by the buyer to produce fragmentised scrap steel, was fitted with a rotor which, if properly used, had an average life of seven years and which, if broken, could only be replaced by a completely new rotor. The rotor, which could have been used for a further 3 3/4 years, was damaged by the use of defective steel which was purchased from the defendants. The buyer purchased a new rotor which had 7 years commercial life. In this case, the Court rejected the sellers' submission that they should only be liable for the proportion of the total cost of the rotor which the old rotor expected life bore to its total life, on the basis that the chattel being replaced was a wasting asset. The Court accepted the submission of buyer that he should be entitled to the whole cost of replacement since replacement was necessary in order to put the fragmentiser back into working order.

The Court in *Bacon* did not consider the decision in *British Westinghouse Electric and Manufacturing Co., Ltd. v. Underground Electric Railways Co. of London, Ltd.*[187] where damages were reduced by an amount equivalent to the profit derived by the use of superior substitute machinery. In normal circumstances, the buyer would not replace the substitute goods till the end of their commercial life. Therefore, the cost of purchasing a new machine will be incurred at the end of the commercial life of the substitute goods. The buyer will have the chance to invest the price of a new machine between the time of expiry of the supposed commercial life of the replaced machine and the end of the commercial life of the substitute machine. Profits derived from investing the price for such a period should be deducted from the buyer's damages. What profit did the buyer derive from the breach in *Bacon?* In this case, the commercial life of the substitute rotor was 7 years whereas the damaged rotor had an expectation of 3 3/4 years of further useful life. Under the above discussion, one may point out that the Court should have considered the profit that could be derived from investing the price of a new rotor for an

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[186] [1982] 1 All ER 397.
[187] [1912] AC 673.

extra 3 1/4, i.e. the period between the end of the supposed life of the rotor and the end of commercial life of the substitute rotor.[188]

However, it seems that the Court in *Bacon* was not convinced that the buyer would use the substitute rotor for all its commercial life due to the type of the fragmentiser. The Court found out that there were new fragmentisers of much better capacity than the fragmentiser in question. Due to that, the Court disregarded the commercial life of the substitute rotor for the purpose of quantifying damages. In this case, Cantley J said "[c]ounsel for the defendants [sellers] says that, if counsel's submission for the plaintiff [buyer] is correct, the defendants would be liable for the cost of a new rotor even if the damaged one had only a few days of remaining useful life. He says that that would be an absurd result. I think it would be. The application of any general principle is inappropriate at the point where it would produce an absurdity. Each case should depend on its own facts."[189] In view of the above discussion, it is submitted that the commercial life should be taken into account unless the facts of the case lead to a different conclusion. The case of *Bacon*, it is submitted, was decided on its own facts.

To sum up, in general, extra profits derived from obtaining substitute goods should be considered in order to reduce the buyer's damages. By ignoring such profit, the buyer may benefit from the breach of contract. Indeed, the objective of damages, as stated in *Robinson*, cannot be achieved by allowing the buyer to benefit from the seller's breach. The exception to this rule is the case of "betterment", as discussed above.

3.5 Can Damages be Awarded for both of the Diminution in Value and Loss of Gross Earning? How can Overcompensation be Avoided?

In general, the objective of compensatory damages, as stated in *Robinson v. Harman,*[190] can be achieved by allowing the buyer damages for his actual losses. However, as stated in chapter one,[191] allowing the buyer for all kinds of damage, caused by the breach, may

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[188] In such a case, it is difficult to assess the profit. Interest on the money for specific period may be considered as equivalent to the profit expected by investing money.

[189] *Bacon v. Cooper (Metals) Ltd.,* [1982] 1 All ER 397, 400. The case of *Harbutt's Plasticine Ltd. v. Wayne Tank and Pump Co. Ltd.,* [1970] 1 All ER 225 can be distinguished from cases such as *Bacon* on the ground that it was a case of a building and not of a wasting asset. See also Jean Braucher, 'An Informal Resolution Model of Consumer Product Warranty Law' [1985] *Wis. L. Rev.* 1405,1429 where the writer suggests that the extension of commercial life resulting from the cure should be considered to reduce the buyer's damages.

[190] (1848) 1 Exch 850, 855. Supra, p.1.

[191] Supra, p.1.

result in overcompensating him. It seems that one must distinguish between the negative results of the breach and the buyer's actual loss caused by the breach. For example, as discussed below, The seller may deliver goods in order to be manufactured with other ingredients to make other products. If the goods appear defective, two kinds of damage may result, i.e. diminution in the value of the goods supplied and diminution in value of the products manufactured. However, in such a case, the buyer's actual loss would not include the diminution in value of the goods supplied. The buyer's expectations under the contract are the profits derived from manufacturing the goods and selling the final products. Indeed, this point needs further discussion which can be found below.[192] At this place, it is enough to say that the buyer's loss of expectations *does not necessarily include, in all cases, every negative result of the breach*. Therefore, in applying the objective of damages, as stated in *Robinson*, the court must look at the *actual loss of expectations* rather than looking at every individual damage caused by the breach. In other words, in applying the principle of *Robinson,* the court must look at the potential economic end-result of the delivery of conforming goods. In fact, allowing the buyer damages for all kinds of damage caused by the breach may put him in a better financial position than he would have been in if the goods had been delivered as warranted. The court should look at the *ultimate* financial position that the buyer would have been in if the goods had not been defective taking into account the information available to the seller at the time of making the contract. Where the goods are bought in order to be manufactured or to be used in business, the court should look at the profit that could have been gained if the goods had been as warranted. This observation will be relied on in the next section to argue issues raised by the decision in *Bence Graphics International Ltd. v. Fasson UK Ltd.*[193]

The concept of "loss of profit" is normally concerned with consequential losses. Loss of profits results normally from the use or loss of use of defective goods. One here should distinguish between gross earnings and net profit. Gross earnings can be understood as the sum of all the receipts earned by the buyer in using the goods.[194] Net profit is the buyer's gross earnings minus all the capital expenses, including the contract price, necessarily incurred by the buyer in order to obtain such gross earnings.[195] In this view,

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[192] Infra, p.97.
[193] [1997] 1 All ER 979.
[194] M.G. Bridge, supra n.68 at p.594.
[195] Ibid, p. 595.

awarding gross earnings occurs presumably where the defective goods are worthless. In such a case the buyer may be entitled to recover his capital expenses plus his lost net profit, i.e. the lost gross earnings. However, where the defective goods are still of value, the court should deduct this value from the whole gross earning. Such a distinction between gross earnings and net profit can help the court to avoid an overlap between the recovery of capital losses such as the price and other expenses incurred in reliance on the contract on the one hand and the recovery for the loss of net profit that the buyer would have had but for the seller's breach on the other.

In the light of the above discussion, one can state that the buyer may be entitled to recover for both his loss of capital expenses and net profit. In the case of *Cullinane v. British "Rema" Manufacturing Co. Ltd.,*[196] the Court misdirected itself when it decided that the buyer should not be allowed damages for his loss of net profit and capital loss. This case will be examined in the next chapter where the quantification of damages for loss of profit, in cases of breach of warranty of quality, is dealt with.

However, the court should not award the buyer for capital loss and loss of gross earnings. In fact, gross earnings include the capital cost. Therefore, allowing the buyer damages for his capital loss and loss of gross earning will put him in a better position than he would have been in had the goods been free from defects. In this sense, the buyer will be overcompensated if he recovers for the diminution in value of a chattel and the loss of its potential production.[197] For example, suppose that the buyer had bought a profit-making machine which appeared defective. Awarding the buyer his loss of the production of the machine over its commercial life, will put him, so far as money can do it, in the same position he would have been in if the machine had been as warranted. By allowing the buyer damages for his normal loss, i.e. the diminution in value of the chattel, the buyer will be overcompensated.

It should be noted that where the defective profit-making goods are valueless, the buyer may not be entitled to recover for the whole loss of gross revenue. In order to avoid overcompensating the buyer under the principle of *Robinson v. Harman,*[198] the court should deduct from the gross revenue the expenses that the buyer has saved by the

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[196] [1954] 1 QB 292.
[197] M.G. Bridge, supra n.68 at 595; Paul Dobson, supra n.18 at p.211.
[198] (1848) 1 Exch 850, 855. Supra, p.1.

reason of the breach. A hypothetical example of a defective quality machine may make this point clearer. Suppose that the buyer paid £1000 as a price of a machine for producing a specific kind of goods which was supposed to earn £3000 during its commercial life. Suppose further that the buyer needed to pay another £1000 for running the machine. If the machine appears defective, the buyer will be entitled to £2000 assessed as follows:

£3000 [gross revenue] - £1000 [the saved expenses].

Here, suppose further that the defective machine was not worthless and the buyer resold it for £200 in an open market. Upon this, the actual loss of the buyer will be £1800 assessed as the following: £3000 [the gross revenue] - £1200 [the saved expenses + the value of the defective goods].

3.5.1 UCC Cases where the Buyer Obtained Double Recovery

The court should not award the buyer damages for both the defective goods and damaged products made by using the defective goods, such as the case of defective herbicide or insecticide. In fact, by allowing the buyer damages for the diminution in the value of the crop, the buyer will be put, so far as money can do it, in the same position he would have been in had the herbicides been free from defects. What happens to the crops as a result of the defective herbicide is different from the diminution in value of the herbicide themselves. However, awarding damages for both losses is inappropriate since the herbicide would be purchased, in any case, to be used to produce the crop. The buyer's *actual loss* in such cases would be the diminution in value of the crop which resulted from the use of defective herbicide. In such cases, the buyer should not be allowed damages for the loss of the diminution in value of the herbicide or insecticide since such goods would be used to produce the crop.[199]

Surprisingly, one may find a number of UCC cases where the buyer was mistakenly overcompensated by allowing him damages for both defective seeds or defective

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[199] Similarly, in *R.E.B., Inc. v. Ralston Purina Co.*, 1975 U.S. App. LEXIS 12294; 18 UCC Rep. Serv. 122 (10th Cir. 1975) where the buyer purchased hog feed which appeared to be defective and killed some of the hogs, the Court awarded damages for the loss of the gross earning which the buyer would have obtained had the hogs been sold. By this award, the buyer has been put in the same position he would have been in had the feed been free from defects. However, the court overcompensated him by allowing him further damages for the diminution in value calculated as the difference between the value of the feed as warranted and their value as received.

herbicide and for the diminution in value of the crops. For example, in *Durham v. Ciba-Geigy Corp.*,[200] where the purchased herbicide appeared defective and damaged the crop of the buyer, the Court allowed damages for the price of the defective herbicide, the profit lost as a result of the reduced crop yield and the cost of fertilizers wasted on the crop. Similarly, in *Swenson v. Chevron Chem. Co.*,[201] the Court awarded for the diminution in value of the crop resulting from a use of defective insecticide plus a full refund of the price of defective insecticide. It is submitted that the Court was mistaken in the quantification of damages in these two cases.

In a case involving the sale of defective herbicide, the United States Court of Appeals for the Fourth Circuit made it clear that the measure of damages in a case of defective herbicide or seeds is the value that the crop would have had if the goods had conformed to the warranty less the value of the crop actually produced, less the expense of preparing for market the portion of the probable crop prevented from maturing.[202] Thereupon, one finds it difficult to understand how the Court in *Albin Elevator Co. v. Pavlica*,[203] allowed the buyer damages for the diminution in the value of the crop resulting from defective seeds used plus the price of the seeds.

In the English case of *Bence Graphics International Ltd. v. Fasson UK Ltd,*[204] the Court of Appeal dealt with the measure of damages in cases where the goods are used as ingredients in industry. In principle, this is similar to the case of the sale of herbicide. Here, the buyer should not be entitled to recover for both the diminution in value of the goods and the diminution in value of the goods manufactured. However, in the case of *Bence,* the buyers managed to sell the defective products to sub-buyers. It is controversial whether the buyers in *Bence* were compensated for their actual loss.

3.5.2 The Issue of *Bence v. Fasson*

In *Bence Graphics International Ltd. v. Fasson UK Ltd,*[205] the sellers supplied cast vinyl film to the buyers in order to be used in manufacturing self-adhesive decals. The buyers were in a business supplying self-adhesive decals to manufacturers of containers used in

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[200] 1982 S.D. LEXIS 262; 33 UCC Rep. Serv. 588.
[201] 1975 S.D. LEXIS 170; 18 UCC Rep. Serv. 67.
[202] *Hill v. BASF Wyandotte Co.*, 1986 U.S. App. LEXIS 22235; 782 F.2d 1212.
[203] 1982 Wyo. LEXIS 358; 34 UCC Rep. Serv. 438 (1982).
[204] [1997] 1 All ER 979.

the carriage of goods. The decals were affixed to the containers in order to be identified by marks printed on the decals by the buyers. It was a term of the contract that the film would survive in a good legible condition for at least five years. However, some of the decals became illegible within the five years due to an insufficient stabilizer which had been used by the defendants in the manufacture of the film. This led to extensive complaints from the customers of the sub-buyer; but only one complaint led to a claim against the buyers who settled it by the supply of new decals at their own expense and in turn received agreed compensation from the defendants. The sellers admitted their liability for the defective film retained by the buyers. The buyers claimed damages for breach of warranty as to the quality of the goods and the sellers admitted their liability for the breach.

At first instance, the Court applied the *prima facie* measure and awarded the buyers damages for the diminution in value of the goods at the time of delivery. However, the Court of Appeal, by a majority, reversed this judgment and awarded the buyers damages to be assessed on the basis of "the [buyers'] liability to the subsequent or ultimate users of the [buyers'] product in which the [sellers'] goods were an integral part and in the event, of a breach of the warranty as to quality, the [buyers'] liability to those others would be triggered."[206]

The court in applying the principle of *Robinson v. Harman,*[207] should look at the final position that the buyer would have been in if the goods had been free from defects. This would be the position that the buyer should be placed in by way of damages in order to achieve the objective of damages stated in *Robinson.* Of course, other principles of law should be taken into account. For example, the buyer will not be entitled to such damages if his expectations were not in the contemplation of the seller at the time of making the contract. Where the goods are purchased in order to be used as ingredients for producing other goods, one may imagine, at least, three types of damage that may result from their defective quality. Firstly, where the buyer discovers the goods defective before he uses them, he may claim damages for the diminution in value which can be calculated under the *prima facie* measure. In such a case, if substitute goods are not reasonably obtainable, the buyer may also claim damages for his loss of *net* profit under

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[205] [1997] 1 All ER 979.
[206] Ibid at p.990.
[207] (1848) 1 Exch 850, 855. Supra, p.1.

sub-buyers and for his liability to sub-buyers. Secondly, where the defective goods are used as ingredients of other products, the buyer's loss would be the diminution in value of the products.[208] This is the case of the aforementioned example of sale of herbicide.[209] In the previous section, it was argued that where the seller's breach caused two types of damage, i.e. diminution in value of the goods supplied and diminution in value of the products manufactured by using the goods as ingredients, the buyer should not be entitled to damages for both types of damage. In such a case, the buyer's damages would be the difference between the actual value of the crops and the value they would have had if the goods had been defect free. Of course, subject to the application of the restrictions imposed on the recovery of damages, the buyer may be entitled to his loss of *net* profit under sub-buyers and for his liability to sub-buyers. Finally, the buyer may resell the products. If this becomes the case, the buyer's loss may be his liability to his sub-buyers.

In a case such as *Bence,* what position would the buyer have been in if the goods had not been defective? The buyer's expectation is to use the goods in industry in order to fulfil subcontracts and, as a result, gain profit. Therefore, if the goods had not been defective, the buyer would have gained profit by performing subcontracts. Therefore, under the principle of *Robinson v. Harman,*[210] damages should be awarded in order to put the buyer in such a position. If the products, manufactured by using the goods as ingredients, were discovered defective after they had been used by sub-buyers, the buyer may be held liable to the sub-buyers. The buyer's profit may be reduced by his liability to the sub-buyers. Therefore, damages should be awarded to compensate him for his liability to the sub-buyers. *Such a liability is the actual detriment suffered by the buyer.* The buyer should not be entitled to more than his actual loss.

Such a loss, i.e. liability to sub-buyers, presumes that there was a diminution in value of the goods purchased and a diminution in value of the products. However, the buyer did not suffer these types of damage. The buyer's actual loss in such a case is his liability to the sub-buyer; and this is the loss that he should be compensated for. In such a case,

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[208] See *Bostock & Co Ltd. v. Nickolson & Sons Ltd* [1904] 1 KB 725 where commercial sulphuric acid warranted free from arsenic was used by the buyer for making brewers sugar, the seller was found in breach of warranty of quality. Thereupon, the buyer was entitled to recover the price paid for the acid and the value of other ingredients spoilt by being mixed with the acid.

[209] Supra, p.94.

[210] (1848) 1 Exch 850, 855. Supra, p.1.

allowing the buyer damages for more than his liability will result in overcompensating him. In the case of *Bence*, the Court of Appeal, by a majority, was reluctant to award damages for diminution in value since the facts of the case "point indubitably against a loss of value basis...".[211] In this case, Otton LJ, said "[i]n my judgment, once the goods had been converted in a manner which was contemplated by the parties... the damages must be assessed by reference to the sub-sale...".[212] The Court made it clear that the *prima facie* measure of damages stated under Section 53(3) is not always applicable. In this respect, Auld LJ said

> "[a]s to s 53(3), there is, in my view, a danger of giving it a primacy in the code of s 53 that it does not deserve. The starting point in a claim for breach of a warranty of quality is not to determine whether one or other party has displaced the *prima facie* test in that subsection. The starting point is the *Hadley v. Baxendale* principle ((1854) 9 Exch 341, [1843-60] All ER Rep 461) reproduced in s53(2) applicable to a breach of any warranty, namely an estimation on the evidence, of "the... loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty". The evidence may be such that *prima facie* test in s 53(3) never comes into play at all."[213]

Nonetheless, where part of the goods are manufactured, the buyer may be entitled to damages for more than one type of the three aforementioned types of loss. The buyer may recover for the diminution in value of the defective goods which have not been manufactured. Also, the buyer may recover for the diminution in value of products made by manufacturing the defective goods. However, where such products are resold, the buyer's liability to the sub-buyers may be considered instead of the diminution in value of the products themselves. In such a case, the buyer would be entitled to recover for the diminution in value of the goods purchased and for his liability to the sub-buyers. This was the case of *Bence.* The buyers did not manufacture all the defective goods. Therefore, their damages were calculated on the basis of the diminution in value of the defective goods which were not manufactured and the liability of the buyers to their sub-buyers.

It should be noted that in the case of *Bence*, it was in the contemplation of the parties at the time of making the contract that the goods were purchased in order to be used in industry. Auld LJ said "[i]t was eminently a case in which they would have contemplated that, in the event of a breach by the seller discovered only after the decals

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[211] *Bence v. Fasson,* [1997] 1 All ER 979, 990.
[212] Ibid at p.989.
[213] Ibid at p.991.

had been in use, the buyer might wish to pass on to it claims for damages from dissatisfied customers."[214] In this sense, the recovery of damages for the seller's liability to the sub-buyers cannot be denied under the remoteness principle.[215] The remoteness principle applies here to allow the buyer damages for losses which are in the reasonable contemplation of the parties at the time of making the contract.[216]

In view of the above discussion, the resale contract should be considered, for the purpose of calculating damages, where it was in the reasonable contemplation of the parties at the time of making the contract. This seems the suitable way to achieve the objective of damages, as stated in *Robinson v. Harman,*[217] and at the same time avoid overcompensating or undercompensating the buyer. Taking the resale into account may increase or decrease the buyer's damages depending on the circumstances of each case. Where the buyer cannot perform the resale contract, he may claim damages for loss of profit on resale and for his liability to the subcontractors. This situation will be examined in detail in the next chapter.[218] However, where the buyer performs the resale contract successfully, his damages may be limited to his liability to the sub-buyer. In *Biggin & Co. Ltd. v. Permanite Ltd. and others*,[219] Devlin J made it clear that the remoteness principle "generally operates in favour of a plaintiff rather than against him, but I think that it is capable of doing either... It has often been held... that the profit actually made on a sub-sale which is outside the contemplation of the parties cannot be used to reduce the damages measured by a notional loss in the market value. *If however*

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[214] Ibid at p.995.

[215] For the remoteness principle, see infra p.284.

[216] See *Hammond & Co. v. Bussey,* [1887] 20 QB 79. In this case, the buyers bought a quantity of the coal for the purpose of resale. The seller was aware of the resale contracts. The coal was discovered defective by the sub-buyers. Thereupon, the buyers paid damages to the sub-buyers. The buyers sued the seller to recover the damages paid to the sub-buyers plus the costs incurred on defending the sub-buyers' action. The Court of Appeal held the seller liable and awarded the buyers the damages paid to the sub-buyers plus the costs of defence. In this case, there was no dispute on whether the measure of damages is the buyers' liability to the sub-buyers. Nevertheless, the Court of Appeal made it clear that in a case such as *Hammond* the proper measure of damages is the buyer's liability to the sub-buyer. The buyer's liability should be in the reasonable contemplation of the parties at the time of making the contract where the seller is aware of the resale. In this case, Bowen, LJ, at p.94, said "The defendant knew for what purpose the plaintiffs were purchasing the coal, viz., to resell it to the owners of steamers, and he must have known as a business man what damages might naturally result to the sub-vendees if it was not reasonably fit for the purposes of steamships, and therefore could not be used by the sub-vendees for such purposes. He may therefore be reasonably supposed to have contemplated, if the warranty were broken, that claims for damages would be made against the plaintiffs by the sub-vendees..."

[217] (1848) 1 Exch 850, 855. Supra, p.1.

[218] Infra, p.127.

[219] [1951] 1 KB 422.

a sub-sale is within the contemplation of the parties, I think that the damages must be assessed by reference to it, whether the plaintiff likes it or not."[220] [Emphasis added]

It is worth mentioning that the remoteness principle applies to the type of loss and not to the measure of damages.[221] It is for the court to specify the measure of damages. Therefore, it may not be proper to apply a specific measure of damages because such a measure was in the contemplation of the parties at the time of making the contract. However, the parties may agree expressly or impliedly on a specific measure of damages. In this sense, one may note that in *Bence* it was not proper to look for the measure that was in the reasonable contemplation of the parties at the time of making the contract. Therefore, it is with many respects strange for the dissenting judge (Thorpe LJ) in *Bence* to rely on the finding of the judge, at first instance, that the parties had not reasonably contemplated the displacement of the *prima facie* measure at the time of making the contract.[222] Professor Bridge, in his interesting comment on *Bence,* asks "since when did the application of damages *rules* have to be contemplated under the rule in *Hadley v. Baxendale*?"[223] In this sense, it seems that the words of Devlin J in *Biggin & Co. Ltd. v. Permanite Ltd. and others*,[224] were not too precise when he pointed out that "... if it is the plaintiff's liability to the ultimate user that is contemplated as the measure of damage and if in fact it is used without injurious results so that no such liability arises, the plaintiff could not claim the difference in market value, and say that the sub-sale must be disregarded."[225]

Turning back to the consideration of resale contracts, a significant question is what damages would the buyer be entitled to if the buyer's liability to the sub-buyers was not in the reasonable contemplation of the parties at the time of making the contract? In

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[220] *Biggin & Co. Ltd. v. Permanite Ltd. and others,* [1951] 1 KB 422 at 435-436. Cited in *Bence v. Fasson,* [1997] 1 All ER 979, 989. The case of *Biggin* involved a sale of certain goods which were resold to the Dutch Government. The original sellers were aware at the time of making the contract that the goods would be resold. Therefore, it was in the reasonable contemplation of the parties that the breach of warranty of quality might lead to the liability of the buyers to the Dutch Government. These were the facts of the case. The buyers were liable to the sub-buyer and they claimed to recover the damages, paid to the sub-buyer, from the seller. In this case, the dispute was about whether the amount paid to the sub-buyer was reasonable. There was no dispute on whether the measure of damages should be the liability to the sub-buyer or the diminution in value. However, the discussion in this case makes it clear that where the resale is in the contemplation of the parties at the time of making the contract, the measure of damages should be, in normal circumstances, the liability of the buyer to the sub-buyer.

[221] G.H. Treitel, *Remedies for breach of contract: A Comparative Account,* Oxford, 1988, p.161.

[222] *Bence v. Fasson,* [1997] 1 All ER 979, 997-8.

[223] Michael G. Bridge, Defective Goods and Sub-sales, [1998] *JBL* 259, 261.

[224] [1951] 1 KB 422.

other words, what would be the recoverable damages, where the resale was not in the contemplation of the parties at the time of making the contract? This may be the case where the nature of the goods does not indicate that the goods will be resold or manufactured. Where the resale is not in the contemplation of the parties at the time of making the contract, the buyer's liability to his sub-buyers will be too remote. As a result, the buyer will not be entitled to recover damages from the seller for such a liability. The seller's liability, in such a case, will be likely to be limited to the normal loss, i.e. the diminution in value of the goods, which should always be in the reasonable contemplation of the parties at the time of making the contract. In awarding damages for the diminution in value in such a case, the issue of overcompensation will not arise since the buyer will not be entitled to recover for his liability to the sub-buyers. However, what would be the case if the difference in value is more than the buyer's liability to the sub-buyers? Will the buyer be entitled to recover, as damages, the difference in value? Compensatory damages should not exceed the buyer's actual loss. By entitling the buyer for more than his actual loss, the buyer will be put in a better financial position than he would have been in if the goods had been free from defects. In other words, the award will clash with the principle of *Robinson v. Harman,*[226] which states the objective of compensatory damages. In such a case, the buyer's loss is less than the difference in value. By awarding the buyer the difference in value, the buyer will be overcompensated. To sum up, in cases of resale, where such a resale is not in the contemplation of the parties at the time of making the contract, the buyer should be entitled to damages for diminution in value or for his liability to the sub-buyers whichever is the least.

It is clear enough that where the goods are resold as defective, damages may be calculated on the basis of the difference between the value of the goods as warranted and the resale price. In cases where the buyer manages to perform subcontracts, made by the time of discovery of defect, by convincing the sub-buyer to accept delivery of defective goods, can the buyer recover damages for diminution in value? In the light of the above argument, one may answer this question in the negative. As the buyer did not suffer a loss *in fact* in such a case, he should not be entitled to more than nominal damages. Actually, the buyer's action of performing subcontracts may be considered as

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[225] *Biggin & Co. Ltd. v. Permanite Ltd. and others,* [1951] 1 KB 422 at 435-436.
[226] (1848) 1 Exch 850, 855. Supra, p.1.

an action of mitigation. It is true that under the mitigation principle, the buyer is not required to enforce sub-contracts where the goods in question are defective. However, if the buyer did mitigate his loss by enforcing such subcontracts, he should not be entitled to recover for such a mitigated loss.[227]

This conclusion seems to be in direct contradiction with the decision in *Slater v. Hoyle & Smith Ltd.*[228] In this case, the sellers delivered part of the goods (1625 pieces of unbleached cotton cloth) which appeared defective. The buyers accepted the goods and paid for them but refused to take any further delivery. Thereupon, the sellers sued them for damages for non-acceptance of the remaining part of the goods. The buyers counterclaimed for damages for breach of warranty in relation to the accepted goods. In this case, the buyers contracted to resell the goods in question. Despite the defect of the goods, they received the whole resale price of the goods from the sub-buyers and they were not sued for their breach of warranty of quality under the subcontracts. The Court of Appeal held that the resale contracts were not to be taken into account in measuring the damages. The Court awarded the buyers the difference between the value of the goods delivered an the value they would have had if they had been defect free.[229] The Court of Appeal disregarded the resale contracts for the purpose of calculation of damages.[230]

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[227] In *British Westinghouse Electric and Manufacturing Co., Ltd. v. Underground Electric Railways Co. of London, Ltd.,* [1912] AC 673 Viscount Haldane stated, at 673, that "when in the course of business... [the plaintiff] has taken action arising out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act."

[228] [1920] 2 KB 11.

[229] Ibid at p.12.

[230] In *Slater's* case, the quantity of goods purchased should have made it clear for the seller that the buyers would resell such goods. Therefore, the resale was in the reasonable contemplation of the parties at the time of making the contract. In *Bence v. Fasson,* [1997] 1 All ER 979 Otton LJ, at p.988, distinguished the case of *Slater v. Hoyle & Smith Ltd.,* [1920] 2 KB 11 on the ground that the seller "did not know of the contemplated sub-sale" unlike *Bence's* case where both parties "were aware of the precise use to which the film was to be put". See Sheila Bone & Leslie Rutherford, 'Damages for Defective Goods with onward Sales' [1997] *S.J.* 138, 139. The remoteness principle does not require the seller to be actually aware of the resale in order to hold him liable in damages for the buyer's liability to the sub-buyers. It seems enough, for the purpose of applying the remoteness principle, that such a resale was in the reasonable contemplation of the parties at the time of making the contract. Therefore, the issue of whether or not the seller was aware *in fact* of the resale contracts is of no relevance. The second branch of the rule of *Hadley v. Baxendale* [1854] 9 Exch.341 provides that "if special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated." In applying the words of this rule to cases of resale, Lord Esher, M.R., in *Hammond & Co. v. Bussey,* [1887] 20 QB 79, at p.89, said "I do not think that there is anything in those words to shew that the second branch of the rule must be confined to the case of a sub-contract already actually made at the time of the making of the contract, and would not

In awarding compensatory damages, one needs to look at the *actual loss* suffered by the aggrieved party. In *Slater's* case the buyers' *actual loss* was their liability to the sub-buyers. In fact, such a liability did not exist since the sub-buyers did not sue the buyers for the defective goods. In *Slater's* case, it seems that the award did put the buyers in a better financial position than they would have been in if the goods had been in conformity with the contract. In other words, the award is inconsistent with the principle of *Robinson v. Harman.*[231] The buyers used the goods successfully to perform their subcontracts. As they did so, they suffered, *in fact,* no loss resulting from breach of warranty of quality.[232] The decision in this case was criticised by Auld LJ in *Bence's* case on the ground that the court wrongly "overlooked the basic rule in Section 53(2) as to what would have been in the ordinary and natural contemplation of the parties in a commercial contract such as it was, namely, that the buyer could well be prejudiced in his onward dealing with the goods if they were defective... and [was] seemingly content to award a buyer more than the evidence clearly showed he had lost."[233] It is submitted that the buyers in *Slater* were overcompensated.

Professor Bridge, in his comment on *Bence,* says that "it is hard to quarrel with a case that refuses damages where no loss has occurred, or can be shown to have occurred in accordance with the normal civil standard of proof."[234] However, he continues to argue that the *prima facie* measure is preferable on the grounds that it is simpler to apply and does not require the buyer to prove losses which are, by their nature, hard to prove.[235] I do agree with Professor Bridge that the measure of damages applied in *Bence* may face the difficulty of application. Although I am inclined to accept the opinion of Professor Bridge as it is satisfactorily justified by the practical difficulties of applying the measure

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apply to the case of a sub-contract not yet actually made, but which will *probably* be made." [Emphasis added]

[231] (1848) 1 Exch 850, 855. Supra, p.1.

[232] The decision in *Slater v. Hoyle & Smith Ltd.,* [1920] 2 KB 11 seems to be inconsistent with the decision in *Wertheim v. Chicoutimi Pulp Co.,* [1911] AC 301. *Wertheim* was a case of late delivery. In this case, the buyer claimed damages for the difference between the value of the goods that would have had if they had been delivered at the right date and their value at the actual date of delivery. The amount claimed was not awarded since the buyer managed to resell the goods at higher price than the market price at the actual time of delivery. The resale was in the contemplation of the parties at the time of making the contract. In this case, the resale price was considered for the purpose of quantifying the buyer's damages. The case was considered in *Slater* and distinguished unconvincingly on the ground that it was a case of late delivery and not of defective quality.

[233] *Bence v. Fasson,* [1997] 1 All ER 979, 994.

[234] Michael G. Bridge, supra n.223 at p.262.

[235] Ibid, p.262.

applied in *Bence*, I find it hard to stand up against such a measure, which in principle allows the buyer damages for his *actual loss*. Indeed, as "difficulties of proof cannot alter the legal principles",[236] the difficult application of a measure of damages cannot be a sufficient ground to abandon such a measure.

Professor Treitel has submitted that the reasoning of *Slater's* case is to be preferred to that in *Bence's* case.[237] In cases of subsale, Professor Treitel distinguishes between two situations i.e. where the buyer can perform his subsale only by delivery of the goods bought under the original contract and the situation where the subsale can be performed by delivery of any goods meeting the description stated in the subcontract but the buyer chooses to deliver the goods which he has bought under the original contract. In dealing with each situation, Professor Treitel says

> "In the first of these situations, the buyer has indeed suffered no loss if the terms of the subsale are either such that the goods are in conformity with that contract or such as effectively to exclude liability for any non-conformity with it arising by reason of the breach of the original contract. The reason why he has suffered no loss is that he had (legally) no choice as to the disposal of the goods, so that they are, in his hands, worth no less than the "full price"; and this must be so whether or not the seller knew of, or ought to have contemplated, the subsale. Hence in such cases the rule in *Slater's* case does not apply. In the second situation, by contrast, the reduction in value of the goods does cause loss to the buyer since (as Scrutton L.J. says in *Slater's* case at p.22) he would have been legally entitled to deliver other goods to the person who might be called his "sub-buyer" (but is not really such) and might have wished to do so if the market had fallen; he would then be left with the defective (and hence less valuable) goods delivered under the original contract. The buyer is initially in the position of having received goods worth less than they should have been and if he is (skilful) or fortunate enough subsequently to avoid or reduce that loss, there is no good reason for passing this benefit on to the seller."[238]

Under such a classification, *Slater* falls under the second situation. By applying the opinion of Professor Trietel, the buyers in *Slater's* case have suffered loss since it was possible for them to fulfil their subcontracts by delivering substitute goods; and, if they had done so, they could have retained the defective goods and claimed damages for diminution in value. However, such an opinion seems to clash with the purpose of awarding compensatory damages in contract law. In contract law, "where a party sustains a loss by reason of a breach of contract he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been

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[236] *Malik v. BCCI* [1998] AC 20, 53 per Lord Steyn.
[237] G.H.Treitel, n.3 at p.195.

performed."[239] In *Slater,* if the goods had been as warranted, the buyers would not have gained more than their profit on resale. In fact, their profit was not reduced by delivering the goods in question. The aim of damages is not to compensate the buyer for loss of profit that he could have made as a result of the breach. Damages should not be awarded for loss of the chance to keep the defective goods and recover damages for diminution in value. Therefore, the buyers in *Slater* should not have been allowed damages calculated on the basis of diminution in value since the award has compensated them for loss of profit that they could have gained as a result of the breach. It is respectfully submitted that the suggestion of Professor Treitel is inconsistent with the purpose of damages in contract law as stated in *Robinson v. Harman.*[240]

It is absolutely true that in certain cases the buyer may retain the defective goods and perform subpurchase contracts by obtaining a substitute from the open market. If this becomes the case, the buyer's actual loss will be for the diminution in value of the contracted goods. The mitigation principle will not arise since the buyer, as previously mentioned,[241] is not required to mitigate his loss by enforcing subcontracts where the goods are defective.[242] Therefore, in the case of *Bence* the buyers were entitled to recover for the diminution in value of the remaining film. However, this should not apply to cases where the buyer does enforce subcontracts by using the goods in question. This was the case of *Slater*. In this case, the buyers did mitigate their loss by enforcing subcontracts which were in the reasonable contemplation of the parties at the time of making the contract. Under the mitigation principle the buyer would not be entitled to damages for losses he avoided *in fact* even where he was not required under the mitigation principle to avoid such losses.[243] Therefore, the buyers in *Slater* should not have been entitled to damages for the diminution in value.

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[238] Ibid at p.192.
[239] *Robinson v. Harman* (1848) 1 Exch. 850, 855 per Parke B.
[240] Ibid, p.855.
[241] Supra, p.102.
[242] Where the buyer retains the defective goods, the mitigation principle requires him to mitigate his loss by obtaining substitute goods to perform subcontracts.
[243] A.G. Guest, supra n.22 at para.16-050; B. Kercher, M. Noone, *Remedies,* 2nd ed., 1990, p.138. See *Erie County Natural Gas and Fuel Co. Ltd. v. Carroll* [1911] AC 105. In this case, the plaintiffs, who carried on an extensive business of quarrying stone and burning lime on their property, sold gas leases, gas grants and gas wells. There was a clause in the contract providing that "It is understood that the parties of the first part [the plaintiffs] reserve gas enough to supply the plant now operated or to be operated by them on said property." The supply of gas, enjoyed by the plaintiffs under the said clause, was cut and the plaintiffs were refused any further supply of gas. Thereupon, the plaintiffs procured the gas required for their plant by the acquisition from independent sources of other gas leases and by the construction of work necessary to obtain the same. In this case, the plaintiffs sold the works used in procuring the substituted

Such an overcompensation was avoided in *Bence* by awarding the buyers for their liability to the sub-buyers of the product in which the sellers' goods were an integral part. Probably, Professor Treitel's classification does not apply to *Bence's* case since the defect of the goods was undiscernibly before they were manufactured. However, suppose that this was not the case and a substitute film was obtainable, one may find that *Bence* falls under the second classification of Professor Treitel. Under such classification, the buyer will be entitled to compensation for the diminution in value of whole goods regardless of the subcontracts. The above argument shows that disregarding the subcontracts in a case such as *Bence* may lead to unjust result, i.e. overcompensation.

To sum up, it seems that the award of the Court of Appeal in *Bence's* case did put the buyers in the same financial position they would have been in if the goods had been in conformity with the contract. In contrast, the decision in *Slater's* case overcompensated the buyers since it put them in a better financial position than the position they would have been in if the goods had been in conformity with the contract. Certainly, the award in *Slater* is inconsistent with the objective of damage stated in *Robinson v. Harman.*[244] It is submitted that the decision in *Bence* is to be preferred to that in *Slater*.

3.6 *Ruxley* and *Bence*: Damages were Rightly Awarded but Defendant was paid for *'skimped'* Performance. Can 'Price Reduction' achieve a better balance? Can Restitutionary Damages be awarded?

Neither the SGA nor the UCC provides expressly for the remedy of price reduction. However, Section 53(1-a) states that the buyer may "set up against the seller the breach of warranty in diminution or extinction of the price".[245] The Section follows the decision in *Mondel v. Steel*[246] where it was made clear that the buyer may defend himself, as against the seller's action for the price, by showing the difference in value caused by the seller's breach of warranty of quality.[247] Therefore, in cases where the

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gas for more than what they cost. Therefore, the House of Lords held that they were entitled only to nominal damages. In this case, the sale price was considered in the quantification of damages. In this case, the plaintiffs chose to mitigate there loss by obtaining a substitute. The avoided loss was considered to reduce the plaintiffs' damages.

[244] (1848) 1 Exch 850, 855. Supra, p.1.

[245] See also Section 2-717 of the UCC.

[246] (1841) 8 M. & W. 858.

[247] See A.G. Guest, *Benjamin's Sale of Goods*, London, 5th ed., 1997, p.932.

seller delivers defective goods, the buyer is entitled to withhold some or all of the price. If the seller sues for the price or the unpaid part of the price, the buyer may set up the diminution in value as a defence.[248] However, for two main reasons, one may state that Section 53(1-a) does not provide for the price reduction as stated under the CISG and the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees.[249] Firstly, under the SGA, the buyer cannot claim price reduction where he has already paid the price. Secondly, the quantification of price reduction is not based on the buyer's loss. Therefore, price reduction, as provided for under the CISG, may exceed or be less than the diminution in value, as discussed below. In this sense, it seems necessary to start with explaining the remedy of 'price reduction' under the CISG.

3.6.1 Price Reduction

Article 50 of the CISG states

> "If the goods do not conform with the contract and whether or not the price has already been paid, the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of the delivery bears to the value that conforming goods would have had at that time. However, if the seller remedies any failure to perform his obligations in accordance with article 37 or article 48 or if the buyer refuses to accept performance by the seller in accordance with those articles, the buyer may not reduce the price."

The origin of the remedy of price reduction is the Roman law which provided for "the buyer's right to reduce the price to the degree of the deficiency -- the *actio quanti minoris*."[250] It has been adopted by the civil legal system countries. In order to achieve uniformity, the CISG includes such a remedy jointly with the remedy of damages, which is the primary remedy under the common legal system. Unlike the common law and the CISG, damages under the civil legal system can be awarded where the seller is at fault. Under the CISG, the buyer by suing for price reduction will not lose his right to claim damages for losses which cannot be recovered by price reduction.[251]

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[248] Christian Twigg-Flesner and Robert Bradgate, "The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees - All Talk and No Do?" [2000] Web JCLI <http:// webjcli.ncl.ac.uk/2000/issue2/flesner2.html>, Section 6-b.

[249] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, Official Journal L 171, 07/07/1999.

[250] John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention,* Boston, 2nd ed., 1991, p.395.

[251] Article 45(2) of the CISG states "The buyer is not deprived of any right he may have to claim damages by exercising his right to other remedy."

The purpose of price reduction is to preserve the bargain and not to compensate the buyer for his actual loss. Under such a remedy, the price can be reduced in order to prevent the seller receiving payment for performance which has not been tendered. In other words, the price is reduced in order to allow the buyer to pay for what he has received. The reduced price is what the buyer is expected to pay for the defective goods at the time of making the contract.[252] Therefore, it can be noted that such a remedy is quasi-restitutionary.[253]

As the goal of price reduction is to preserve the bargain, Article 50 of the CISG does not allow such a remedy where the bargain can be preserved by the seller's cure of the defect provided that the seller is entitled to cure the defect under the provisions of the CISG.[254] Where the seller does not cure the defect or does not have the right to cure, the price can be reduced whether or not the buyer has paid the price. If the buyer has not paid the price, he may pay a reduced price. However, the buyer needs to claim price reduction in cases where he has paid the price. Here, it is worth mentioning that an interesting essay, which deals with the application of Article 50 of the CISG in USA and Mexico, shows that the buyer normally relies on Article 50 in order to defend the seller's action for the price.[255] This may be understandable on the grounds that Article 50 allows the buyer to reduce the price unilaterally in cases where the seller delivers non-conforming goods. In other words, the buyer does not need to sue the seller in order to reduce the price unless he has already paid the price and seeks to recover part of it. However, if the buyer pays a reduced price, the seller may sue him for the balance. This is why in most cases Article 50 is used as a defence where the seller sues for the price.

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[252] Peter A. Piliounis, "The Remedies of Specific Performance, Price Reduction and Additional Time (*Nachfrist*) under the CISG: Are these Worthwhile Changes or Additions to English Sales Law", 1999 Pace Essay, <http://cisgw3.law.pace.edu/cisg/biblio/piliounis.html>, text accompanying n.109..

[253] See Christian Twigg-Flesner and Robert Bradgate, "The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees - All Talk and No Do?" [2000] Web JCLI <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html>, Section 6-b.

[254] Article 37 of the CISG states "If the seller has delivered goods before the date for delivery, he may, up to that day, deliver any missing part or make up any deficiency in the quantity of the goods delivered, or deliver goods in replacement of any non-conforming goods delivered or remedy any lack of conformity in the goods delivered, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. However, the buyer retains any right to claim damages as provided for in this Convention."
Article 48(1) of the CISG states "Subject to Article 49, the seller may, even after the date for delivery, remedy at his own expense any failure to perform his obligations, if he can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement by the seller of expenses advanced by the buyer. However, the buyer retains any right to claim damages as provided for in this Convention."

Under Article 50, price reduction can be claimed regardless of whether the buyer suffered loss or not. Therefore, under the facts of *Bence Graphics International Ltd. v. Fasson UK Ltd*,[256] the buyer may still be entitled to price reduction even though he did not suffer any loss. Even in cases where the buyer suffers actual loss, he may choose to claim damages for diminution in value or price reduction depending on the amount that he can recover under each remedy. In all cases, where the buyer did not suffer, or cannot prove his, loss, price reduction provides the buyer of a better recovery than damages.

The reduced price that the buyer can pay due to the seller's breach can be quantified under Article 50 as follows:[257]

$$\frac{\text{Reduced Price}}{\text{Contract Price}} = \frac{\text{Value of the Goods Delivered}}{\text{Hypothetical value of conforming goods}}$$

In applying this formula, the goods should be valued at the time of delivery.[258] The market price can always be considered where the goods can be obtained from an open market. Where the market price is not available, the contract price may be considered in valuing the goods as warranted. In such a case, the defective goods may be valued by estimating the depreciation in value caused by the defect.

In all cases, the 'subjective value' or 'consumer surplus' should not be considered in quantifying price reduction. This is due to the fact that price reduction is not concerned with the buyer's loss. In this sense, the resale price cannot be considered in valuing the goods unless such a price is the market price at the time of delivery. Moreover, cost of cure cannot be considered in quantifying price reduction. In brief, all the elements which are concerned with the buyer's loss cannot be considered for the quantification of price reduction. In this sense, the restrictions imposed on the recovery of damages do not

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[255] Arnau Muriá Tuñón, "The *Actio Quanti Minoris* and Sales of Goods between Mexico and the U.S.: An Analysis of the Remedy of Reduction of the Price in the UN Sales Convention, CISG Article 50 and its Civil Law Antecedents", 1998 Pace Essay, <http://cisgw3.law.pace.edu/cisg/biblio/muria.html>.

[256] [1997] 1 All ER 979.

[257] The formula is quoted from Peter Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods*, Oxford, 2nd ed., 1998, p.441.

[258] The 1978 draft of the Convention states that the value of the goods should be measured at the time of the conclusion of contract. In order to avoid constructing a theoretical value that might not have existed at the time of making the contract, the time of delivery was considered to calculate the price reduction under Article 50 of the Convention. See John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention,* Boston, 2nd ed., 1991, p.396. See also Eric E. Bergsten & Anthony J. Miller, "The Remedy of Reduction of Price" (1997) 27 *American Journal of Comparative Law* 255.

apply to cases where the buyer claims price reduction. Such restrictions are concerned with the buyer's loss.

It seems that, under the remedy of price reduction, the buyer's recovery may exceed damages for normal loss in two cases, i.e. where the buyer's actual loss is less than the diminution in value and where the buyer has made a bad bargain. As price reduction does not depend on the buyer's loss, the first case is clear. As mentioned above, if the buyer's damages are calculated on the basis of his liability to sub-buyers, the buyer may claim price reduction where such a liability does rise. A simple example may explain the latter case. Suppose that a buyer purchased a quantity of goods at a price of £1000. Suppose further that the market price of the goods dropped between the time of making the contract and the time of delivery. At the time of delivery, the value of the goods as warranted was £800. However, due to a defect in the goods, the value of the goods at the time of delivery was £700. In this example, if the buyer claims damages for diminution in value, he will recover £100 (the difference between the value of the goods as warranted £800 and their value as defective £700). However, under the remedy of price reduction, the buyer may recover more than the diminution in value. The reduced price will be quantified as follows:

$$\frac{\text{Reduced Price}}{£1000} = \frac{£700}{£800} \qquad \text{Reduced price} = \frac{(1000)(700)}{800} = £875$$

In effect, the buyer will recover £125 (the contract price £1000 minus the reduced price £875). In this sense, it can be noted that where the buyer has made a bad bargain, it may be better for him to sue for price reduction than claiming damages. However, where the buyer has made a good bargain, it would be better for him to claim damages for diminution in value instead of price reduction. In the mentioned hypothetical example, suppose that the value of the goods as warranted at the time of delivery was £1200 and their value as defective was £900. The buyer's damages for diminution in value would be £300 calculated as the difference between the value of the goods as warranted £1200 and the value of the goods as defective £900. Under the remedy of price reduction, the buyer will recover £250 since the reduced price will be £750 calculated as follows:

$$\text{Contract price (£1000)} \times \frac{\text{Value of the goods as defective (£900)}}{\text{Hypothetical value of the goods as warranted (£1200)}}$$

By claiming price reduction, the buyer will not lose his right to claim damages for losses resulting from the breach such as expenses incurred due to the breach, loss of profit, etc.[259] However, where the buyer claims price reduction and damages for all his losses caused by the breach, damages should be reduced by the amount which the buyer has received by way of price reduction.[260] In all cases, the buyer is advised to claim price reduction jointly with damages. In a case such as *Bence,* could the buyer under the CISG sue for price reduction and damages for his liability to sub-buyers if he was successfully sued by sub-buyers? In *Bence*, damages were calculated on the basis of the buyers' liability to sub-buyers and the buyers were not allowed damages for diminution in value. In such a case, the court should take into account the fact that the buyer's actual loss is his liability to sub-buyers and not the diminution in value. Therefore, if such a case is ever decided under the CISG, it is submitted that the buyer's damages should be reduced by the amount that the buyer has received by way of price reduction. However, one may argue that in a case such as *Bence* the buyer should be entitled to claim price reduction and damages for his liability to sub-buyers since price reduction can be claimed regardless of whether or not the buyer has suffered loss. However, under this argument, where the buyer's actual loss is the diminution in value of the goods, the buyer should be entitled to both damages for diminution in value and price reduction. This is definitely unacceptable result. It is true that the literal reading of Article 45 may allow the buyer to claim both damages for diminution in value and price reduction; however, there is no sense in doing so since the buyer's damages should be reduced by the amount received by way of price reduction.[261]

Nevertheless, in certain cases the buyer may not be allowed to claim damages under the CISG and, hence, price reduction becomes his only way to obtain monetary relief. Under Article 79 of the CISG, the buyer may not be entitled to recover damages for losses resulting under circumstances beyond the seller's control and could not reasonably be expected at the time of making the contract.[262] Therefore, in cases of perishable goods, the value of the goods may deteriorate due to their late delivery which was caused by

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[259] Article 45(1)(b) of the CISG.

[260] Peter Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods*, Oxford, 2nd ed., 1998, p.444.

[261] Ibid, p.444.

[262] Article 79(1) states "A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences."

circumstances beyond the seller's control, such as labour strike, war, etc.[263] In such a case, if the buyer accepts the goods, he will not be entitled to damages. However, the buyer may claim price reduction since the exemption, provided for in Article 79, does not apply to claims other than damages. Article 79(5) of the CISG states "Nothing in this Article [Article 79] prevents either party from exercising any right other than to claim damages under this Convention."

3.6.2 Evaluation

In certain circumstances, price reduction may offer the buyer a better recovery than damages. More importantly, in certain cases, price reduction can be the only way available for the buyer to obtain monetary relief under the CISG. Nevertheless, although price reduction prevents the seller receiving payment for performance which has not been made, it may allow the buyer to gain more than he could have gained if the goods had been delivered as warranted.

The purpose of price reduction is not to make the promise economically efficient. In fact, the remedy of damages is more concerned with the economic efficiency of the promise. Therefore, compensatory damages are awarded to compensate the buyer for his loss regardless of whether the seller received payment for performance which he had not made. In view of that, there seems to be a difference in the purpose of each remedy. Whilst the remedy of damages is intended to secure the economic end-result of proper performance, the remedy of price reduction is concerned with the payment for performance received. Such a difference seems to be due to moral consideration rather than economic one.[264] In fact, the morality of price reduction seems to be similar to the morality of specific performance. Both remedies are concerned with the seller's actual performance of the contract. Under specific performance, the seller should perform what he promised under the contract; under price reduction, the seller is not entitled to keep or claim payment for performance which he had not made.[265]

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[263] See Anette Gärtner, "The Vienna Convention on the International Sale of Goods Contains some Well-known Inconsistencies, but there is much in it which worth preserving and which better accords with commercial reality than the Sale of Goods Act 1979", 1998 Pace Essay, <http://cisgw3.law.pace.edu/cisg/biblio/gartner.html>.

[264] Arnau Muriá Tuñón, "The *Actio Quanti Minoris* and Sales of Goods between Mexico and the U.S.: An Analysis of the Remedy of Reduction of the Price in the UN Sales Convention, CISG Article 50 and its Civil Law Antecedents", 1998 Pace Essay, <http://cisgw3.law.pace.edu/cisg/biblio/muria.html>, text accompanying n.173.

[265] Ibid, text accompanying n.173.

It might be argued that in cases where price reduction exceeds the diminution in value, the buyer may be placed by way of price reduction in a better financial position than the position he would have been in if the goods had been delivered as warranted. However, in certain cases, the buyer may not be entitled to recover damages for the diminution in value, such as the case of *Bence.* Therefore, disallowing the buyer to claim price reduction in such a case may put the seller in a better financial position than the position he would have been in if he had delivered conforming goods. This can be understandable on the ground that the seller may save expenses by delivering non-conforming goods. Therefore, it seems that none of the remedies of price reduction and damages put both parties in the same position they would have been in if the contract had been properly performed.

Although the remedy of compensatory damages can be justified in commercial contracts as it, so far as possible, secures the economic end-result of proper performance by compensating the buyer for his actual loss, both remedies of price reduction and damages should be available in consumer cases in order to provide consumers of better protection. The remedy of price reduction may be brought into English law from the civil legal system after the implementation of the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees.[266] Article 3(2) of the Directive states

> "In the case of a lack of conformity, the consumer shall be entitled to have the goods brought into conformity free of charge by repair or replacement... or to have an appropriate reduction made in the price or the contract rescinded with regard to those goods..."

Here, it should be noted that price reduction is not available under the Directive unless repair or replacement, which are kinds of specific performance, are impossible or disproportionate.[267] The Directive does not provide a way to quantify price reduction. In fact, this is a fundamental gap in the Directive since the method of quantification and the time of valuation of goods are of vital significance for the application of price reduction in order to achieve its objective, i.e. to prevent the seller from receiving

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[266] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, Official Journal L 171, 07/07/1999.
[267] Article 3(3) of the Directive states "In the first place, the consumer may require the seller to repair the goods or he may require the seller to replace them, in either case free of charge, unless this is impossible or disproportionate."

payment for performance which he had not made. It is unclear how price reduction will be quantify by the English courts. The courts may look at the practice in other European countries or at the CISG.

To sum up, it seems convenient to allow both remedies of price reduction and damages in cases of defective goods. Each remedy has its own purpose. However, allowing price reduction under English law may raise some issues. For example, if the buyer is entitled to claim price reduction in sale of goods cases, why should not the plaintiff in cases of construction contracts be entitled to claim payment reduction where the performance is defective? This issue may not arise under the civil legal system due to the generosity of such a system in granting specific performance. Under such a remedy, the plaintiff is entitled to receive what he contracted for. Under English law, specific performance can be granted exceptionally where the remedy of damages is inadequate. This may be the case where the goods in question are unique and, therefore, substitute goods are not available.

As previously mentioned, in a case such as *Bence,* price reduction may place the buyer in a better financial position than the position he would have been in if he had received conforming goods. In *Bence,* the buyer's actual loss was his liability to the sub-buyers. On the other hand, the award in *Bence* allowed the defendant to gain from his breach by saving the expenses that he should have incurred in order to perform the contract properly. It seems that non of price reduction or compensatory damages prevents the parties to gain more than they have expected to gain under the contract. Can restitutionary damages achieve a better balance if they are recoverable in sale of goods cases?

3.6.3 Restitutionary Damages for Defective Performance

Under the remedy of restitutionary damages, the innocent party is entitled to recover the profit gained by the other party from his breach of contract. Here, it is worth noting that the House of Lords in the recent case of *Attorney-General v. Blake*[268] seemed to be unhappy with the term 'restitutionary damages' due to the fact that damages are normally concerned with the innocent party's loss and not with the profit gained by the

[268] [2000] 3 WLR 625.

party in breach.[269] Nevertheless, Lord Steyn made it clear that the "terminology... is less important than the substance".[270]

Restitutionary damages can be awarded under special circumstances. For example, restitutionary damages may be awarded in cases of breach of fiduciary duty.[271] However, such damages are generally unavailable for breach of contract. Exceptionally, they may be awarded for a breach of restrictive covenant.[272] Birks suggests that restitutionary damages should be awarded in cases where the breach is cynical.[273] This suggestion was rejected in *Attorney-General v. Blake*[274] where it was made clear that the fact that the breach is cynical and deliberate is not a reason to allow restitutionary damages.

In *Tito v. Waddell (No. 2),*[275] Sir Robert Megarry V.-C. pointed out that the question of damages "is not one of making the defendant disgorge what he has saved by committing the wrong, but one of compensating the plaintiff."[276] Only in exceptional cases, the innocent party may be entitled to recover restitutionary damages. In *Attorney-General v. Blake,*[277] where the House of Lords allowed restitutionary damages, Lord Nicholls of Birkenhead stated that

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[269] Ibid, Lord Nicholls of Birkenhead p.638, Lord Steyn p.644.
[270] Ibid, p.644.
[271] Lord Goff of Chieveley and Gareth Jones, *The Law of Restitution,* London, 1998, p.713.
[272] *Wrotham Park Estate Co. Ltd. v. Parkside Homes Ltd.* [1974] 1 WLR 798. In this case, the defendants had built houses on their land in breach of a restrictive covenant in favour of the plaintiffs' neighbouring land. A mandatory injunction was refused on the ground that it would cause economic waste. The plaintiffs were allowed 5% of the profits gained by the defendants. Damages were allowed in this case on the basis of the amount that the plaintiffs would have demanded from the defendants for relaxing the covenant.
[273] Peter Birks, "Restitutionary Damages for Breach of Contract: *Snepp* and the fusion of law and equity" [1987] *LMCLQ* 421, 440.
[274] [2000] 3 WLR 625, 640.
[275] [1977] Ch. 106.
[276] Ibid at p.332.
[277] [2000] 3 WLR 625. In this case, the defendant was a former member of the Secret Intelligence Service S.I.S. who in 1944 signed an undertaking not to divulge any official information gained as a result of his employment. However, in 1989, he wrote an autobiography, substantial parts of which were based on information he had acquired in the course of his duties as an S.I.S. officer. The defendant was held in breach of contract. Lord Nicholls of Birkenhead, at p.641, pointed out that "[t]he undertaking, if not a fiduciary obligation, was closely akin to a fiduciary obligation, where an account of profits is a standard remedy in the event of breach. Had the information which Blake [the defendant] has now disclosed still been confidential, an account of profits would have been ordered, almost as a matter of course. In the special circumstances of the intelligence services, the same conclusion should follow even though the information is no longer confidential. That would be a just response to the breach." The House of Lords held that the case is of special circumstances where restitutionary damages can be awarded. In a case of similar facts, *Snepp v. US* (1980) 444 US 507, the United States Supreme Court allowed restitutionary damages.

> "there seems to be no reason, *in principle*, why the court must in all circumstances rule out an account of profits as a remedy for breach of contract. I prefer to avoid the unhappy expression "restitutionary damages". Remedies are the law's response to a wrong (or, more precisely, to a cause of action). When, exceptionally, a just response to a breach of contract so requires, the court should be able to grant the discretionary remedy of requiring a defendant to account to the plaintiff for the benefits he has received from his breach of contract."[278]

For the purpose of this thesis, the question is whether restitutionary damages can be awarded in cases of defective goods. In the Court of Appeal, the question was dealt with in *Attorney-General* by Lord Woolf M.R. where he pointed out that restitutionary damages can be allowed in cases of 'skimped' performance.[279] In other words, such damages can be awarded where the defendant fails to provide the full extent of services he has contracted to provide and for which the plaintiff has paid or has to pay under the contract. In such a case, restitutionary damages would be quantified on the basis of the expenses saved by the defendant in not performing the contract properly. However, in the House of Lords, Lord Nicholls of Birkenhead stated that this issue does not fall within the scope of an account of profits. He said that "[i]f a shopkeeper supplies inferior and cheaper goods than those ordered and paid for, he has to refund the difference in price. That would be the outcome of a claim for damages [compensatory damages] for breach of contract."[280] However, how can this apply in cases where there is no diminution in market value, i.e. difference in market value, resulting from defective performance, such as the case of *Ruxley Electronics and Construction Ltd. and another v. Forsyth*?[281] How can this apply in cases where the difference in market value is not the buyer's actual loss, such as the case of *Bence Graphics International Ltd. v. Fasson UK Ltd*?[282] The recovery of the difference in the market price may not be always possible. In *Ruxley,* the House of Lords brought about justice by allowing the plaintiff damages for loss of amenity. However, damages for consumer surplus may not be always available since they are subject to the normal restrictions imposed on the recovery of damages. It seems that they can only be available where enjoyment or amenity is one of the main purposes of the contract.[283]

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[278] *Attorney-General v. Blake* [2000] 3 WLR 625, 638.
[279] [1998] 1 All ER 833, 845.
[280] *Attorney-General v. Blake* [2000] 3 WLR 625, 640.
[281] [1996] 1 AC 344.
[282] [1997] 1 All ER 979.
[283] Brian Coote, "Contract Damages, *Ruxley,* and the Performance Interest" [1997] CLJ 537, 565.

Restitutionary damages as well as price reduction may allow the buyer to recover more than he would have received if the goods had been delivered as warranted. On the other hand, compensatory damages may allow the party in breach to receive payment for performance which has not been made. Harris, Ogus and Phillips state that prevention of the injured party's recovering a windfall may have the result that the windfall accrues to the party in breach. Therefore, they suggest that any windfall should be apportioned between the parties.[284] Probably, this may be a convenient approach in cases where defective performance substantially increases the defendant's profit while not materially reduces the plaintiff's expectations.

As previously mentioned, the remedy of price reduction will be brought into English law through the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees.[285] The purpose of the Directive is to achieve a "minimum harmonization" of the several consumer laws among the legal systems of the member states.[286] Therefore, the consumer buyer may have a better protection by offering him the choice to sue for price reduction, damages or both. However, this does not achieve a perfect balance for the law since the plaintiff in other kinds of contract, such as construction contract, will not be allowed to claim payment reduction. The remedy of restitutionary damage may provide help here. However, such a remedy is unlikely to be generally available in the near future since the Law Commission has recommended that the recoverability of restitutionary damages is most appropriate to be left for common law development.[287] In the light of the above discussion, it is submitted that more attention should be paid to the suggestion of Harris, Ogus and Phillips that any windfall gained by the defendant as a result of his defective performance should be apportioned between the parties. This seems to bring about justice as non of the parties will be allowed to gain alone more than he expected under the contract. This requires a legislative intervention since the common law is not familiar with such a solution.

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[284] D. Harris, A. Ogus and J. Phillips, 'Contract Remedies and Consumer Surplus' (1979) 95 LQR 582, 593-4.

[285] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, Official Journal L 171, 07/07/1999.

[286] See Christian Twigg-Flesner and Robert Bradgate, "The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees - All Talk and No Do?" [2000] Web JCLI <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html>, Section 2.

[287] Law Commission, Aggravated, Exemplary and Restitutionary Damages, Law Com. No 247, para. 1.48.

Conclusions

The objective of compensatory damages, as stated in *Robinson v. Harman*,[288] cannot be achieved without considering the subjective value of the goods in calculating damages for normal loss. Ignoring the subjective value may result in undercompensating the buyer. However, in considering the subjective value for quantifying the buyer's damages, other principles should be taken into account. Taking the subjective value into consideration should always be subject to the remoteness principle. In general, loss of 'consumer surplus' is recoverable as long as it complies with the normal restrictions imposed on the recovery of damages. For example, where it is reasonable for the buyer to avoid such a loss by obtaining substitute goods, the recovery for such a loss may be disallowed due to the application of the mitigation principle.

In order to achieve the objective of damages, as stated in *Robinson*, the *prima facie* measure should be displaced where its application would not put the buyer in the same financial position as if the goods had been confirming or where its application undercompensates or overcompensates the buyer. Cases, where the *prima facie* measure can be displaced, cannot be put in an exhaustive list. Where the cost of cure exceeds the difference in value, the *prima facie* measure should be displaced in order to allow the buyer damages for his actual loss, i.e. cost of cure. However, this should be subject to the normal restrictions imposed on the recovery of damages. Therefore, in order to allow the buyer to recover, as damages, the cost of cure, such a cure should be the only way to deal with the seller's breach. In other words, where it is possible for the buyer to resell the defective goods and obtain substitute goods, he may not be entitled to more than the difference between the price of resale and the cost of substitute. Moreover, the recovery of cost of cure is subject to the restriction of reasonableness as stated in *Ruxley Electronics and Construction Ltd. and another v. Forsyth.*[289] The buyer will not be entitled to recover the cost of cure where it is unreasonable to cure the defective goods. The buyer is not expected to cure the defective goods where the cost of cure is very disproportionate to the difference in value. It is true that awarding the cost of cure achieves the objective of compensatory damages stated in *Robinson*. However, the balance of the law will not be achieved by such an award where the application of other principles of law disallow such an award. Indeed, the restriction of reasonableness is

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[288] (1848) 1 Exch 850, 855. Supra, p.1.
[289] [1996] 1 AC 344.

significant to achieve the balance of the law since such a principle prevents 'economic waste'.

The main question regarding the recoverability of the cost of cure, which exceeds the diminution in value, is whether the buyer can recover for such a loss where the cure makes the goods of a better quality than the quality they would have had if they had been as warranted. Obviously, in such a case, allowing the buyer the cost of cure will put him in a better financial position than he would have been in had the goods been delivered as warranted. Although the award of the cost of cure seems to clash with the objective of compensatory damages, as stated in *Robinson,* it does not overcompensate the buyer since the only way to deal with the seller's breach is to cure the defect of the goods. Of course, the buyer should not be entitled to such a recovery where substitute goods are reasonably obtainable or where the cure is unreasonable. In view of that, one may conclude that although the award in *Harbutt's Plasticine Ltd. v. Wayne Tank and Pump Co. Ltd.*,[290] put the plaintiff in a better position than the position he would have been in if the breach had not happened, the plaintiff was not overcompensated since he had no choice other than reinstating the property. In fact, disallowing the cost of cure would undercompensate the plaintiff since the plaintiff was forced to incur such a cost in order to deal with the defendant's breach. In view of that, it can be concluded that the decision in *Harbutt's Plasticine* is an exception to the rule of damages stated in *Robinson.* It is submitted that such an exception is necessary in order to hold the seller liable for losses caused by his breach and award the buyer for the expenses caused by the breach which could not reasonably be avoided.

However, this should not be the case where cure increases the productive capacity of the goods or, in cases of replacement, the substitute goods are of better productive capacity than the goods in question. In this case, allowing the buyer the cost of cure or replacement will definitely overcompensate him since the buyer will gain profit derived from the increased productive capacity. Therefore, the court should reduce the buyer's damages by the amount of profit gained from the increased productive capacity in order to avoid overcompensating the buyer. By this way, the court may strike the right balance in awarding compensatory damages by ensuring that the objective of damages, as stated in *Robinson,* is achieved and the buyer is not overcompensated. Based on the decision in

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[290] [1970] 1 All ER 225.

British Westinghouse Electric and Manufacturing Co. Ltd. v. Underground Electric Railways Co. of London Ltd[291] the following formula is submitted to be considered for the quantification of damages:

([cost of replacement + extra expenses incurred in using defective goods] – [the salvage value of the defective goods + extra profit derived from the superiority of the substituted goods])

Furthermore, in cases of replacement, the substitute machine may be of a longer commercial life than the remainder of the potential commercial life of the replaced machine. Where it is proved that the buyer was supposed to buy new machine at the end of the commercial life of the replaced goods, the buyer will gain extra profit by not having to buy a new machine until the end of the commercial life of the substitute machine. In other words, the buyer will have the chance to invest the price of a new machine between the time of expiry of the potential commercial life of the replaced machine and the end of the commercial life of the substitute machine. Profits derived from investing the price for such a period should be deducted from the buyer's damages. Deciding otherwise may result in putting the buyer in a better financial position than he would have been in if the goods had not been defective and, consequently, the award will be in direct contradiction with the principle of *Robinson.* Although the commercial life was not taken into consideration to reduce the buyer's damages in *Bacon v. Cooper (Metals) Ltd*,[292] this chapter argued that the case was decided on its own facts. In this case, the Court was not convinced that the buyer would use the substitute goods for all their commercial life.

The question of whether subsales can be considered for the quantification of damages has been answered in the positive. Where the subsale was in the contemplation of the parties at the time of making the contract and the buyer resold the goods, damages should be calculated on the basis of the buyer's liability to his sub-buyers. Where the goods are bought in order to be manufactured, the buyer may be entitled to damages for the diminution in value of the products caused by using the defective goods purchased. However, where the buyer performed subcontracts by delivering such products, as in

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[291] [1912] AC 673.
[292] [1982] 1 All ER 397.

Bence Graphics International Ltd. v. Fasson UK Ltd,[293] his damages should be limited to his liability to the sub-buyers. This is due to the fact that the *actual loss* caused by the seller's breach is the buyer's liability to his sub-buyers. The buyer should not be entitled to recover more than his actual loss. In fact, one may argue that allowing the buyer to recover damages for more than his actual loss clashes with the objective of damages stated in *Robinson.* In applying the principle of *Robinson,* the court should look at the economic end-result of the performance and not at the direct result of performance. If the seller is aware that the goods will be resold or manufactured, damages should be awarded to secure the economic end-result of performance, i.e. the potential profit. In a case such as *Bence,* if the goods had not been defective, the buyer would have manufactured them and *successfully* sold the products to the sub-buyers. Therefore, in such a case, it can be argued that under the principle of *Robinson,* compensatory damages should be awarded in order to put the buyer, so far as money can do it, in the position he would have been in had he *successfully* performed his subcontracts by delivering conforming products. This can be achieved by allowing the buyer damages for his liability to the sub-buyers. Therefore, contrary to the opinion of respected writers such as Treitel, it is submitted that the case of *Bence* was rightly decided by allowing the buyers damages for their actual loss.

However, where the subcontracts are not in the contemplation of the parties at the time of making the contract, it has been submitted that the buyer should be entitled to recover for the diminution in value or for his liability to the sub-buyer whichever is the least. This is due to the fact that the buyer's *actual loss* is his liability to the sub-buyer. But the seller's liability should not exceed the diminution in value since the subsale was not in the contemplation of the parties at the time of making the contract. Therefore, in principle, the sub-buyer is entitled to damages for the diminution in value; however, where the buyer's liability to the sub-buyer is less than the diminution in value, the buyer should not be entitled to damages for more than his liability to the sub-buyer which represents his *actual loss*. Where the buyer managed to perform subcontracts, made by the time of discovery of defects, by convincing the sub-buyers to accept delivery of defective goods, he should be entitled to no more than nominal damages. In such a case, the buyer suffers no *actual loss*. Here, it is submitted that the buyers in

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[293] [1997] 1 All ER 979.

Slater v. Hoyle & Smith Ltd.[294] were overcompensated by awarding them damages calculated on the basis of the difference in value.

In *Ruxley* and *Bence,* the defendant received payment for performance that he did not make. In other words, the defendant gained from his breach. On the other hand, if the plaintiff had been allowed restitutionary damages or price reduction he would have been overcompensated since his recovery would have exceeded his actual loss. In order to deal with this point, an attention should be paid to the suggestion of Harris, Ogus and Phillips that any windfall should be apportioned between the parties.

All in all, it can be noted that in awarding compensatory damages for normal loss, English law strikes the right balance by ensuring that the objective of damages, as stated in *Robinson,* is achieved and ensuring that the buyer is not overcompensated. The decision in *Bence* should be understood as a development in English law in the right direction. The decision emphasizes that damages are a question of fact and should not be awarded for more than the actual losses caused by the seller's breach.

The UCC is, to some extent, similar to the SGA with respect to the case of normal loss. The only difference seems to be the time at which goods are valued for the purpose of applying the *prima facie* measure. Whilst goods are valued at the time of delivery under the SGA, they are valued at the time of acceptance under the UCC. In fact, such a difference is not significant due to the fact that the court always values the goods at the time when the buyer has a reasonable chance to discover the defect. Valuing the goods at a different time may not achieve the objective of damages, as stated in *Robinson,* since this would be the time when the buyer can decide to resell the defective goods and obtain a substitute. In distance sales, the goods may be delivered when the seller hands them over to the carrier or sends them by post. At this time, the buyer may not have any reasonable chance to discover the defect of the goods. Therefore, it can be noted that the time of acceptance is more appropriate to be used in the *prima facie* measure than the time of delivery since this brings the law into line of reality.

However, it can be noted that although the time of valuing the goods stated under the UCC is to be preferred to that stated under the SGA, in practice such a difference is not

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[294] [1920] 2 KB 11.

significant since the measure is *prima facie.* As previously noted, the English and American courts may depart from the *prima facie* measure to value the goods at other than the time of delivery or acceptance. For example, in at least three cases, the court is unlikely to value the goods at the time of delivery. These cases are (a) where the defect cannot be discovered, or become certain, before using the goods; (b) where the buyer has passed the goods to a sub-buyer without examining them and the seller was aware, at the time of making the contract, of the subsale; (c) where the seller caused a delay in the resale of the defective goods.

In comparing English law with American law, one may note that the American courts are less concerned with the *actual loss* suffered by the buyer. In a number of UCC cases, such as *Durham v. Ciba-Geigy Corp.*[295] and *Swenson v. Chevron Chem. Co.,*[296] the buyer was overcompensated by awarding him damages for the diminution in value of the goods supplied and for the diminution in value of the products made by using the goods as ingredients. It was argued that the buyer should only be entitled to recover damages for the diminution in value of the products manufactured. To sum up, one may note that although the rules under the UCC states the objective of damages, which is identical to that in England, the practice of the courts does not show a satisfactory achievement of such an objective.

As regards the CISG, due to the lack of cases, this work could not go beyond analysis of its provisions. The Convention does not provide a measure for quantifying damages in cases of breach of warranty. However, the words of Article 74 of the Convention may lead to the application of the *prima facie* measure. Where there is a fluctuation in the market value of the goods, the *prima facie* will apply under the Convention in order to achieve the objective of compensatory damages. The time of valuing the goods is the time when the buyer has a reasonable chance to discover the defect of the goods. The recoverability of damages calculated on the basis of cost of cure depends on the actual loss recognized by the court. Article 74 allows damages for the actual loss caused by the seller's breach.

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[295] 1982 S.D. LEXIS 262; 33 UCC Rep. Serv. 588 (1982).
[296] 1975 S.D. LEXIS 170; 18 UCC Rep. Serv. 67 (1975).

Chapter Four

Damages for Consequential Economic Losses: Recoverability and Quantification of Loss of Profit

Introduction

Consequential economic losses can be loss of profit and expenses caused or wasted by the seller's delivery of defective goods. The quantification of loss of profit seems to be a difficult task as compared to other types of economic loss. The issue of this chapter is whether the objective of damages, as stated in *Robinson v. Harman,*[1] was achieved in cases where the defective quality of goods caused consequential economic loss. In order to ensure that the law strikes the right balance by achieving the objective of compensatory damages and avoiding overcompensating the buyer, this chapter will develop methods that can be applied in quantifying the buyer's damages. In cases of profit-making goods, the quantification of loss of profit depends on many factors such as the productive capacity, the annual earnings and the salvage value. The buyer may also lose the chance of investment of the annual earnings that he would have made but for the breach. Loss of investment should be quantified for the period within which the annual earnings could have been invested. The buyer may also lose profit resulting from delay in the operation of his factory due to defective machines delivered by the seller. Furthermore, the buyer may suffer loss of profit resulting from loss of goodwill caused by delivery of defective goods.

Compensatory damages are quantified under both the SGA and the UCC similarly. Therefore, the methods of quantifying loss of profit developed in this chapter should apply under English and American jurisdictions similarly. In developing formulas concerned with the quantification of damages for such losses, one has to take into account the normal restrictions imposed on the recovery of damages. The most important restriction which needs to be considered in relation to loss of profit is certainty.

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[1] (1848) 1 Exch 850, 855. Supra, p.1.

English law seems to be different from American law regarding the requirement of certainty. Therefore, this chapter will deal with such a requirement under each law in order to conclude which law is better in applying the requirement of certainty. In fact, until recently, the American courts were reluctant to allow the recovery of loss of profits in most cases of sale of goods. The so-called "new business rule" was applied to prevent recovery of loss of profit in all cases of new business. Under English law, the "new business rule" does not exist. The rule was justified by American courts on the ground that new businesses have no previous records of profit and, thus, loss of profit cannot be proved with reasonable certainty. The rule is still influential in the American courts. This work will argue that the "new business rule" should be regarded as evidential rule and should not be regarded as a rule of law. In other words, where the buyer shows that his new business suffered loss of profit, the "new business rule" should be set aside. Here, one needs to find out what degree of certainty is required in proving the fact and amount of loss of profit. Indeed, where the buyer can show, by any means, that he has suffered loss of profit, it becomes the duty of the court to quantify such a loss.

A comparison between English law and American law is also necessary in cases where the buyer claims his wasted pre-contract expenses. English law seems to be also different from American law regarding the question of whether the buyer is entitled to recover pre-contract expenses wasted by a breach of contract. Therefore, one needs to find out which law deals better with this question. This chapter will argue that such expenses should be recovered, as damages, under the normal restrictions imposed on the recovery of damages. In general, where the buyer does not suffer loss of profit or cannot prove such a loss with reasonable certainty, he may choose to claim the expenses wasted by the breach. The buyer's expenses incurred in reliance on the contract may be wasted due to the seller's delivery of useless goods. Now, it seems well settled that the buyer will not be entitled to recover all his capital expenses where the seller proves that his capital expenses exceed his gross earnings, i.e., where the buyer has made a bad bargain.

4.1 Loss of Profit

Economists measure profit as the difference between revenue and expenses.[2] The famous economist Sir John Hicks made it clear that "income [net profit] is that amount

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[2] M.L. Katz and H.S. Rosen, *Microeconomics,* Boston, 3rd ed., 1998, p.208.

which an individual can consume and still be as well off at the end of the period as he or she was at the start of the period."[3] Apparently, this definition is restricted to the net profit and cannot apply to the gross earnings.[4] Net profit can simply be identified as the total earning diminished by the cost of obtaining it.

In principle, loss of profits is recoverable under the SGA and the UCC. Historically, the American court was reluctant to award damages for loss of profit.[5] As for the CISG, Article 74 provides expressly that "damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party...." The reason that the Article made a specific reference to the loss of profit is that the concept of loss, in some legal systems, does not include loss of profit unless a specific reference is made.[6] While the concept of loss, in such legal systems, is restricted to the reduction in the assets caused by the breach (*damnum emergens*), the concept of profit is concerned with any increase in assets which would have been obtained but for the breach (*lucrum cessans*).[7] Some legal systems do not recognize the loss of profit or it may allow its recovery subject to special requirements.[8]

None of the SGA, the UCC nor the CISG provides guidelines for the quantification of such a loss. The Secretariat's Commentary to the CISG provides some examples for such a quantification under Article 74 of the Convention.[9] Unfortunately, the examples do not cover many positions of recovery in respect of retained defective goods. Consequential loss of profit can be suffered as a result of loss of resale or as a loss of using profit-making goods.

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[3] 1930. Quoted from A. Berry and R. Jarvis, *Accounting in a Business Context*, London, 3rd ed., 1997, p.25.

[4] For the distinction between "net profit" and "gross earning", see supra p.92.

[5] Infra, p.146.

[6] Knapp, Damages in General, in C.M. Bianca and M.J. Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention*, Milan, 1987, 543.

[7] Peter Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods (CISG),* Oxford, 2nd ed. in translation by Geoffrey Thomas, 1998, p.563. See also F. Enderlein and D. Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods: Convention on the Limitation Period in the International Sale of Goods,* New York, 1992, p.299.

[8] Peter Schlechtriem, ibid at p.563.

[9] Document *A/CONF.97/5*. See comment 5 to Article 70 of the 1978 draft of the CISG [currently Article 74 of the CISG].

4.1.1 Loss of Profit on Resale

As previously mentioned,[10] in applying the principle of *Robinson v. Harman*[11] the court should look at the economic end-result that the buyer could have achieved if the seller had delivered conforming goods. Therefore, if it was in the contemplation of the parties that the goods will be resold, the resale should be taken into account in quantifying the buyer's damages. Taking the resale contracts into account for the purpose of calculating damages may increase or reduce the buyer's damages. The previous chapter dealt with cases where the buyer can mitigate his loss by performing subcontracts. Commonly, the buyer may contract to resell the goods before the time of delivery under the original contract. It has been stated that the buyer is not required under the mitigation principle to perform such subcontracts by delivering the defective goods. However, the buyer may mitigate his loss by reselling the goods as defective.[12] So, where the buyer does not perform subcontracts by delivering the defective goods, he may lose profit, as a result of loss of resale, and be liable for non-delivery of goods to the subcontractors. In such a case, the buyer may recover damages for loss of profit on resale,[13] for his liability to the sub-buyers and for diminution in value of the goods in question. However, where substitute goods are reasonably obtainable, the mitigation principle may require the buyer to perform subcontracts by delivering substitute goods in order to avoid his liability to the subcontractors.

Under both English and American law, the recovery of such lost profit is subject to two main restrictions.[14] First, it should be in the reasonable contemplation of the parties, at the time of making the contract, that the goods are bought for resale.[15] Secondly, the buyer is required to prove that the goods are no longer suitable for performing subcontracts or the sub-buyers rejected them due to their defective quality.[16] Nonetheless, it should be noted that it is still arguable whether or not resale contracts

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[10] Supra, p.92.
[11] (1848) 1 Exch 850, 855. Supra, p.1.
[12] For the mitigation principle, see infra p.298.
[13] See M.G. Bridge, 'Expectation damages and uncertain future losses' in J. Beatson and D. Friedmann (eds.), *Good faith and fault in contract law*, Oxford, 1995, 427, at pp.449-452. Loss of profit on resale frequently occurs in cases of non-delivery. See Richard Schiro, 'Prospecting for Lost Profits in the Uniform Commercial Code: The Buyer's Dilemmas' (1979) 52 *S. Cal. L. Rev.* 1727.
[14] See the leading UCC case of *Hendricks & Associates, Inc. v. Daewoo Corporation* 1991 U.S. App. LEXIS 269; 13 UCC Rep. Serv. 2d 1099 (1991).
[15] See the opinion of Lord Denning M.R. regarding the parties' contemplation of loss of profit in *Parsons Ltd. v. Uttley Ingham & Co.* [1978] 1 QB 791, 802. See also E.C. Schneider, 'Consequential Damages in the International Sale of Goods: Analysis of Two Decision' (1995) 16 *U. Pa. J. Int'l Bus. L.* 615, 636.

can be considered for the purpose of calculating damages. In reliance on the argument placed in the previous chapter, one may note that the failure of the court to consider resale contracts where such resale was in the contemplation of the parties at the time of making the contract, may be in direct contradiction with the principle of *Robinson v. Harman.*[17] Here, the buyer should show that he did not enforce subcontracts by delivering the goods in question due to their defective quality.

Loss of profit on resale can be quantified on the basis of the difference between the resale price and the contract price. However, the diminution in value of the goods in question should be taken into account. For example, suppose that the buyer had contracted to resell at £1000 and the original contract price was £800. If the buyer could not perform subcontracts due to the defective quality of goods, he would be entitled to recover £200 (the difference between the resale price and the original price). Suppose further that the value of the goods as warranted was £700. In such a case, the buyer's loss would be £300 (the difference between the resale price and the value of the retained goods).

The recoverability of damages for loss of profit on resale may not be difficult where the buyer shows that he contracted to resell the goods by the time the goods were discovered defective. However, this may not be the case where the buyer bought the goods to hold in inventory for future resale. If these goods appear defective by the time of their resale, the buyer should show evidence of the price at which the goods would have been resold but for the breach. Here it should be clear that if the buyer saved expenses, which would have been incurred on the resale but for the breach, such expenses should be deducted from his total recovery.[18]

4.1.2 Loss of Use

Under English and American jurisdictions, the out-of-pocket expenses suffered by the buyer as a result of his loss of use of the defective goods are recoverable. Such expenses

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[16] W.H. Henning and G.I. Wallach, *The Law of Sales under the Uniform Commercial Code*, 1981 including 1995 supplement, p.10.33.
[17] (1848) 1 Exch 850, 855. Supra, p.1.
[18] In the UCC case of *Wullschleger & Co., Inc., v. Jenny Fashions, Inc.,* 1985 U.S. Dist. LEXIS 15612; 41 UCC Rep. Serv. 1213 (1985) where the buyer purchased certain kind of fabric which appeared defective, he was entitled to recover, as damages, the loss of net profit, resulting from cancellation of purchase orders made by customers, minus labour expenses saved as a result of the breach.

can be expected to be in one of two forms. First, the buyer may repair the goods in question. Here, he may be entitled to the rental value of substitute goods during the period of repair plus the cost of repair provided that such a repair is reasonable in the circumstances.[19] Secondly, the buyer may recover as damages expenses incurred in obtaining substitute goods subject to the reasonableness requirement. However, where substitute goods are unobtainable, the buyer may suffer a loss of profit. In the UCC case of *Maru Shipping Co. v. Burmeister & Wain Am. Corp.*,[20] the seller was held liable for repair cost attributable to defects in the engines purchased plus profits lost during the repair. Where the goods are repairable, the buyer may suffer loss of profit during the period of repair.

4.1.2.1 Loss of Use by Manufacturer Buyer

The buyer, in this context, is the person who purchases goods in order to be used for profit-making industry. The loss of profit of such a buyer may result from a shutdown of his business or deficiency in the normal production of the business. In order to apply the principle of *Robinson v. Harman*[21] in this case, one has to look at the financial position that the buyer could have been in if the goods had operated as warranted for their commercial life. Furthermore, the principle of *Robinson* has to be applied in conjunction with other principles, especially the principles of mitigation and certainty.

The remoteness principle is unlikely to prevent the recovery of loss of profit resulting from the deficiency of the profit-making goods. The seller, who deals with a commercial buyer, normally contemplates, at the time of making the contract, that the buyer will use such goods for a profit-making scheme and it is unlikely that such a profit will be gained if the goods appear defective. In the UCC case of *Lewis v. Mobile Oil Corp.*,[22] the United States Court of Appeals for the Eighth Circuit made it clear that where a seller provides goods to a manufacturing enterprise with knowledge that they are to be used in

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[19] In the case of *Charterhouse Credit Co. Ltd. v. Tolly,* [1963] 2 QB 683 where the buyer refused to pay instalments due to a finance company under a hire-purchase agreement, the company terminated the contract and claimed damages. The defendant counterclaimed for damages for defective quality of the car, i.e. the subject-matter of the contract. In this case, Upjohn LJ, at p.711, made it clear that in principle the buyer can recover as damages the cost of hiring substitute goods for the period of repair plus the cost of repair.

[20] 1981 U.S. Dist. LEXIS 9944; 33 UCC Rep. Serv. 230 (1981).

[21] (1848) 1 Exch 850, 855. Supra, p.1.

[22] 1971 U.S. App. LEXIS 12487; 8 UCC Rep. Serv. 625 (8th Cir. 1971). See also the UCC case of *Draft Systems, Inc. v. Rimar Manufacturing, Inc.* 1981 U.S. Dist. LEXIS 16779; 32 UCC Rep. Serv. 1493 (1981).

the manufacturing process, it is reasonable to assume that he should know that defective goods will cause a disruption of production, and loss of profits is a natural consequence of such disruption. Similarly, comment 6 to Article 70 of the 1978 draft [currently Article 74] of the CISG provides expressly that "... If the goods delivered were machine tools, the buyer's loss might also include the loss resulting from lowered production during the period the tools could not be used."[23] The comment is concerned with losses resulting from the delay in operation. Obviously, the comment does not deal with losses caused by the deficiency of the productive capacity of the purchased goods themselves. However, Article 74 of the Convention is wide enough to award damages for such losses.

4.1.2.1.2 The Failure of the Court to Apply the Principle of *Robinson v Harman*

Where profit-making goods appear of deficient productive capacity, the buyer needs to consider whether or not he can mitigate his loss by continuing to use the goods in question. As discussed below, in certain cases, the mitigation principle may require the buyer to stop using the goods or obtaining substitute. However, where the mitigation principle does not arise, the buyer may be entitled to recover damages for loss of profit resulting from the deficiency of the productivity of the goods in question. The objective of damages, as stated in *Robinson v. Harman,*[24] can be achieved by the allowing the buyer the difference between the actual profit he earned and the profit he could have earned if the goods had been delivered as warranted. Of course, if the buyer cannot gain profit due to the seller's breach, he may stop using the goods and sue for his lost expectations.

In one English case, *Cullinane v. British "Rema" Manufacturing Co. Ltd.*,[25] the court failed to achieve the objective of damages by undercompensating the buyer for his actual loss resulting from the deficient productive capacity of the goods supplied. In this case the plaintiff purchased a clay pulverising and drying plant from the defendant. The plant was supposed to produce dry clay powder at the rate of six tons per hour.[26] The

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[23] Document *A/CONF.97/5.*

[24] (1848) 1 Exch 850, 855. Supra, p.1.

[25] [1954] 1 QB 292. The decision in this case was criticized and damages were reassessed in J.K. Macleod, Damages: Reliance or Expectancy Interest, [1970] *JBL* 19.

[26] It seems that the buyer, in this case, was in breach of warranty of fitness for a particular purpose which is the special capacity of production.

commercial life of the plant was ten years. The plant, however, was not as productive as warranted. It was capable of producing two tons per hour only. The buyer claimed damages for expenses incurred in reliance on the contract plus the loss of net profit. Surprisingly, the Court of Appeal held that the buyer was entitled to recover either his loss of profit or his total expenditures.[27] In *Cullinane*, Sir Raymond Evershed, M.R. pointed out that

> "[a]s a matter of principle again, it seems to me that a person who has obtained a machine such as the plaintiff here obtained, which was mechanically in exact accordance with the order given, but was unable to perform a particular function which it was warranted to perform, may adopt one of two courses. He may... claim to recover the capital cost he has incurred less anything he can obtain by disposing the material that he got. *A claim of that kind puts the plaintiff in the same position as though he had never made the contract at all. He is, in other words, back where he started, and, if it were shown that the profit earning capacity was, in fact, very small, the plaintiff would probably elect so to base his claim*. **Alternatively**, he may, where the warranty in question relates to performance, make his claim on the basis of the profit he has lost, because the machine as delivered fell short in its performance of that which was warranted to do."[28] [Emphases added]

The statement by Sir Raymond Evershed, M.R. applies accurately to cases where the buyer seeks to recover, as damages, loss of gross earnings and the expenses incurred in reliance on the contract. The buyer will obtain double recovery if he is allowed his loss of *gross earnings* and expenditure incurred for obtaining such *earnings*. This is based on the fact that such expenditure constitutes part of the gross earnings. In this sense, the buyer can recover, as damages, either his gross earnings or expenditure incurred for obtaining such earnings.[29] By allowing the buyer damages for both losses, the court will not comply with the principle of *Robinson*.

However, in *Cullinane* the buyer claimed his *net profit* and his total expenditure incurred for obtaining the gross earnings. The buyer's *net profit* is the difference between the gross earnings and the capital expenditure including the price. Therefore, the buyer will by no means be overcompensated by allowing him damages for his loss of

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[27] The decision has been criticized in S Stoljar, 'Nominal, Elective and Preparatory Damages in Contract' (1975) 91 *LQR* 68, 80. See generally A.G. Guest, *Benjamin's sale of goods*, London, 5th. ed., 1997, p.949; Harvey McGregor, *McGregor on Damages,* London, 16th ed., 1997, p.595.

[28] *Cullinane v. British "Rema" Manufacturing Co. Ltd.*, [1954] 1 QB 292, 303.

[29] The buyer may claim the expenditures wasted where loss of profit cannot be proved with reasonable certainty. For example, in *Wood prods., Inc., v. CMI Corp.,* 1986 U.S. Dist. LEXIS 19198; 4 UCC Rep. Serv. 2d 407 (1986) the buyer was entitled to refund the purchase price plus extra costs by using machinery, minus revenue actually generated by machinery, but buyer failed to prove lost profits with sufficient certainty.

net profit and such expenditure.[30] In general, where the productive capacity of the defective goods is less than what is agreed upon, the buyer will not, in normal circumstances, be overcompensated by allowing him his net profit plus his total expenses which were disposed due to the breach.[31]

In *Anglia Television Ltd. v. Reed,*[32] Lord Denning MR referred to *Cullinane* to allow, as damages, expenses wasted by the breach where loss of profit was not claimed. He stated that the aggrieved party "can either claim for his loss of profit; or for his wasted expenditure. But he must elect between them. He cannot claim both."[33] In this case, it is unclear what Lord Denning MR meant by the word 'profit'. It is hoped that he meant gross earnings and not net profit.[34] Interpreting such a statement differently may lead to undercompensation.

To sum up, the decision in *Cullinane,* it is submitted, did not comply with the principle of *Robinson* due to its failure to distinguish between gross earnings and net profit. In fact, the damages claimed in *Cullinane* comply with the principle of *Robinson.* The classification of Sir Raymond Evershed, M.R. should apply *only* where the buyer claims his capital expenses and loss of gross earnings.

4.1.2.1.2 Formula for the Calculation of Damages under the Principle of *Robinson v Harman*

Where the mitigation principle does not arise and the buyer uses the defective profit-making goods for their commercial life, the following points should be considered in quantifying the loss of profit in order to achieve the objective of compensatory damages. Firstly, the running expenses of the goods at their lower productive capacity might be

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[30] In the UCC case of *Sweco, Inc., v. Continental Sulfur and Chemical,* 1991 Tex. App. LEXIS 488; 14 UCC Rep. Serv. 2d 1034 (1991) the buyer was allowed damages for the diminution in value of a defective mill and for loss of profit.

[31] See *George Mitchell (Chesterhall) Ltd v. Finney Look Seeds Ltd.* [1983] 2 AC 803 where the buyer purchased specific kind of seeds which appeared defective, the House of Lords awarded the buyer all his costs, wasted in cultivating the worthless crop, as well as the net profit he would have made from a successful crop.

[32] [1972] 1 QB 60. The case was of a contract between a television company and an actor. The company incurred expenses before making the contract. The actor, in breach of contract, refused to do the contracted film. The Court of Appeal awarded the expenses wasted by the breach of contract. In this case, the plaintiff did not claim damages for his lost profit due to the difficulty of proving that the film would have been profitable. The case was referred to in *Bed Dis a Turk Ticaret v. International Agri Trade Co. Ltd. (The "Selda")* [1998] 1 Lloyds Rep. 416.

[33] *Anglia Television Ltd. v. Reed,* [1972] 1 QB 60, 63-4.

[34] See Hugh Beale, *Remedies for Breach of Contract,* London, 1980, 156.

less than they would have been if the goods had operated at the agreed productive capacity. Secondly, the residual value of the defective goods at the end of their commercial life, i.e. the salvage value, would be lower than the residual value of the goods as warranted. In some cases, the salvage value equals zero. The following section provides methods that should be considered in quantifying damages for defective profit-making goods.

To make the case clearer, the following will state a method of measurement of the buyer's loss of profit in a hypothetical example inspired by the case of *Cullinane*.[35] Suppose that a plant was purchased in order to produce widgets at the rate of ten per hour. But, due to the defective quality of the plant, its productive capacity decreased to eight widgets per hour. Moreover, the gross revenue of the plant as warranted was expected to be [£27,000] per annum and the running expenses[36] of the operation were expected to be [£1000].

In this case, the annual earning would be [£26,000] calculated as the annual gross revenue [£27,000] less the annual running expenses [£1000]. Further, suppose that the commercial life of the plant was 10 years. Suppose further that the contract price of the plant and expenses incurred in reliance on the contract was [£50,000]. Also the residual value[37] of the plant at the end of its commercial life was [£1000]. The total net profit of the buyer over the commercial life of the plant would be calculated as follows:

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[35] One cannot provide certain formulas for the calculation of damages in all cases of lost profits. The court may find its own way in the calculation of damages. The example provided is concerned only with goods of deficient productive capacity. In *Koufos v. C. Czarnikow Ltd. (Heron II)* [1969] 1 AC 350, Lord Upjohn, at p.425, said that "[t]he assessment of damages is not an exact science".

[36] In this example, the average running expenses is used. The running expenses do not include the overhead expenses which are incurred whether the machine is in operation or not. Economists distinguish between a firm's fixed and variable costs. The former are always stable whether or not the firm does anything such as the employees' salaries. The latter are those that vary with the firm's activity. This might be the costs of certain materials used to manufacture certain product. In the normal course of circumstances, fixed costs may not be taken into account for the calculation of damages. However, in certain cases fixed expenses may be considered for the purpose of quantifying damages. For example, suppose that the buyer has purchased a machine to use it in his factory. Suppose further that all the products of the machine appeared to be defective due to the defect of the machine. In such an example, if the buyer claimed the wasted expenses only, one might find a ground for considering the employees' salaries for the purpose of calculating the buyer's damages. The buyer's employees might have had more time to devote to some other profitable work if the buyer did not purchase the goods in question. In such an example, the buyer has paid the salaries without receiving any financial benefit in return. Therefore, the court might allow the buyer part of the salaries equivalent to the time spent on operating the defective machine. This was decided by the United States Court of Appeals for the Seventh Circuit in *Autotrol Corporation v. Continental Water Systems Corporation* 1990 U.S. App. LEXIS 20376; 918 F.2d 689 (1990).

[37] Some writers consider the depreciation for the quantification of damages. Such a consideration has no significance where the annual earnings are considered since such earnings are normally reduced by the

(*the gross earnings in ten years* [10(26,000)] + *the residual value of the plant at the end of its commercial life* [£1000]) *less the contract price of the plant and any further expenses incurred in reliance on the contract* [£50,000] = £211,000.

If the plant was of a lower productive capacity than the contracted productive capacity, three figures are likely to change, i.e. the running expenses,[38] the annual gross revenue and the residual value. Suppose that the figures changed as follows: the running expenses [£700], the annual gross revenue [£22,000] and the residual value of the plant at the end of its commercial life [£900]. The annual earning would be [£22,000 - £700 = £21,300]; the gross earnings at the end of the commercial life of the plant would be [£10 (21,300)]. The buyer's total net profit would be calculated as

(*the gross earnings at the end of the plant's commercial life* [£213,000] *plus the salvage value of the plant* [£900]) *less the contract price of the plant and any further expenses incurred in reliance on the contract* [£50,000] = £163,900

In this hypothetical example the lost net profit suffered by the buyer due to the deficiency in the productive capacity can simply be quantified as follows:[39]

the expected taxed net profit if the plant operated as warranted [£211,000] - *the actual taxed net profit that the buyer gained* [£163,900] = £47,100

Here, it should be noted that where the damages awarded are subject to tax in the buyer's hand, the tax should not be taken into account for the quantification of damages. However, where the tax rate changes between the time of the buyer's loss and the time of the award, the difference in the tax rate should be taken into account. For example, in the recent case of *Amstrad Plc. v. Seagate Technology Incorporated and Another,*[40]

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depreciated value. Moreover, the value of the plant normally depreciates during its commercial life to reach eventually the salvage value which should be considered in the assessment of damages. See J.K. Macleod, supra n.25.

[38] The deficiency in the productive capacity may increase the productive costs. In this case, damages should be allowed for such extra costs. For example, see *Hawthorne Industries, Inc. v. Balfour Maclaine International Ltd.,* 1982 U.S. App. LEXIS 18869; 33 UCC Rep. Serv. 1339 (11th Cir. 1982) where damages were allowed for the increased productive costs.

[39] The provided formula is based on the analysis in N. Biger and A.S. Rosen, 'A Framework for the Assessment of Business Damages for Breach of Contract' (1980-81) 5 *Can. Bus. L.J.* 302.

[40] [1997] 86 *BLR* 34 (Unreported). In this case, the plaintiff purchased a quantity of hard disk drives from the defendant. The drives appeared defective. The plaintiff showed evidence that the failure of the drives

where the tax rate at the time of the award was less than the tax rate at the time when the buyer suffered loss of profit, the buyer's damages were reduced in order to take account of the difference in the tax rate.

A significant restriction of the recovery in cases such as the aforementioned example is the mitigation principle. In certain cases, the buyer may mitigate his loss by stopping using defective goods and obtaining substitute goods. Here, the buyer will not be compensated for losses he could have avoided by obtaining such a substitute. In this case, he would be entitled to recover as damages the cost of the substitute goods plus his loss of net profit over the period preceded the replacement of the defective goods. Where substitute goods are unobtainable, the buyer may have no choice other than continuing to use the goods and claiming damages for loss of profit. However, obtaining substitute goods may not be a mitigating step in all cases.[41] The buyer may mitigate his loss by continuing to use the defective goods for their commercial life. This can be the case where the deficiency of the productive capacity is trivial. Where substitute goods are unobtainable and the buyer's loss can be mitigated by stopping using the defective goods, the buyer may be required to stop using defective goods under the mitigation principle.[42] In this case, the buyer would recover for his loss of net profit during the period of using the machine plus his loss of gross earnings for the remaining period of the commercial life of the machine after subtracting the running expenses which were supposed to be incurred if the machine operated as warranted.

4.1.2.1.3 Loss of Chance of Investing the Annual Earnings

Turning back to the annual earnings, presumably the buyer would put the annual earnings to other profit-making businesses. In this sense, where the productive capacity of the goods is deficient, the buyer will be deprived from investing the annual earnings that he would have gained if the goods had been free of defect. The court may decide to award the buyer interest for the loss of such investment. In the USA such rate is subject

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made his computers unmarketable and, consequently, he suffered loss of profit. It was held that the buyer was entitled to recover damages for lost and delayed sales of its computers and for wasted costs.

[41] Where the buyer cannot afford to obtain a substitute machine, the mitigation principle will be unlikely to require him to obtain such a substitute.

[42] Supra, p.298.

to local law rules which vary widely from one state to another.[43] However, in cases of loss of investment, it does not seem wise to fix a rate of interest for the reason that the rate of profit that the buyer lost is normally changeable depending on the circumstances of each case.

Therefore, Biger and Rosen, in their interesting article on the calculation of damages,[44] suggest a method for the quantification of damages for loss of investing the annual earnings. Suppose that the annual loss of earnings, in the aforementioned hypothetical example, was [X]. In this case, if the buyer had gained [X] in the first year, he would have invested it at the end of the year. In this sense, his damages for such a loss should be quantified for the remaining nine years of the commercial life of the plant.[45] Suppose that the buyer's profit of investment of [X] was [0.2], his expected net profit gained by the investment of [X] for one year would be [X (0.2)]. The outcome would probably be invested for the second year. If this becomes the case, his expected net profit after the second year would be [$X(0.2)(0.2) = X(1+0.2)^2$]. After the ninth year, the expected net profit would be [$X(1+0.2)^9$]. As for X of the second year, the expected net profit should be quantified for the remaining 8 years of investment. Such damages would be [$X(1+0.2)^8$] for the second year; [$X(1+0.2)^7$] for the third year and so on. In this view, the total damages for the loss of chance of investing the annual earnings would be quantified as follows

$$X(0.2)^9 + X(0.2)^8 + X(0.2)^7 + \ldots + X(0.2)$$

Here it should be clear that in this example it is supposed that damages are awarded at the end of the commercial life of the plant. However, if damages are claimed at a point within the commercial life of the machine, damages for the loss of chance of investment would be calculated for the period before the time of award.

4.1.2.1.4 Delay in Operation of Business

The delay in operation due to a breach of warranty of quality is indisputably a ground for the award of damages. In this case, such damages may include expenses that the

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[43] R.R. Anderson, 'Incidental and Consequential Damages' (1987) 7 *J. L. & Com.* 327, 432. See also *H.S. Lee, E. Lee and L. Lee v. Joseph E. Seagram & Sons, Inc.,* 1979 U.S. App. LEXIS 17862; 26 Fed. R. Serv. 2d 1086 (2nd Cir. 1979).

[44] See N. Biger and A.S. Rosen, supra n.39 at p.312.

[45] Ibid.

buyer incurred during the delay period. The head (home) office expenses are normally not included in such a recovery since they are normally constant and in no way attributable to or affected by the seller's breach. However, this may not be the case where the buyer is running a small business and the seller's breach affects the whole operation of the business. Here, the head office expenses are likely to be recoverable. The main issue arising under this title is concerned with profits gained by putting the capital for other profitable uses during the period of delay.

In order to achieve the objective of damages, as stated in *Robinson v. Harman,*[46] the buyer's award should be reduced by the amount of expenses saved due to the delay in operation. By ignoring such expenses, the buyer will be put in a better financial position than the position he would have been in if the operation of business had not delayed. In other words, the buyer will be overcompensated. Moreover, the buyer may decide to free his capital in order to be put to another profitable use during the period of delay. If this becomes the case, can the seller get credit from profit gained by the use of the capital? In other words, should the profit gained by using the capital during the delay period, be deducted from the total amount of damages?

By applying the rule that the buyer should be compensated for losses he suffered *in fact*, the answer to the question should be in the positive.[47] It is plain that ignoring profit gained by using the capital in the period of delay, will put the buyer in a better financial position than he would have been in if the goods had been free of defect. The answer can be based on the mitigation principle.[48] Where the buyer took successful steps to mitigate his loss, although he was not required to do so under the mitigation principle, the outcome of such steps should be considered for the quantification of damages.[49] In this sense, where the buyer gained a profit by putting his capital to other profitable uses during the period of delay, although he was not required to do so under the mitigation principle, any resulting profit should be deducted from the total amount of damages.

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[46] (1848) 1 Exch 850, 855. Supra, p.1.

[47] See A.G. Guest, *Chitty on Contracts*, London, Vol.1, 28th ed., 1999, para.27-096 where it is shown that release of resources for other uses is considered in cases of termination of contract. The buyer's damages may be reduced by the amount of profit, which is gained by release of resources for other uses.

[48] See F.L. Williamson, 'Remedies—Lost Profits as Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated' (1978) 56 *N.C. L. Rev.* 693, 730.

[49] For the mitigation principle, see infra p.298.

Hypothetically, let us suppose that the capital of investment is £1000 and the period of delay due to the seller's breach is 2 years. Suppose further that the annual percentage of the expected profit during the period of delay is 30% and the annual percentage of the profit gained by using the capital for other profitable business during the same period is 10%. Suppose further that the buyer's claim was for his loss of profit only. Williamson, in his interesting article on loss of profits, provides helpful analysis regarding the quantification of loss of profit in such a case.[50] Based on the analysis of Williamson, the formula of quantifying the buyer's loss of profit in such a case would be

[(total expected percentage on return on capital - the percentage on actual return) x (capital investment)] x number of years of recovery period.

If the buyer put the whole capital, in the mentioned example, for other profitable uses during the period of delay, his loss of profit would be

[(30% - 10%) x (1000)] x 2 = £ 400

Here, it should be noted that the formula applies only to the capital which is invested during the delay period. If the buyer invested only part of the capital, his loss of profit on the other part should be calculated on the expected percentage of profit.[51] For example, suppose that the buyer in the mentioned example invested only £500, his loss of profit on this amount would be

[(30% - 10%) x (500)] x 2 = £200

His loss of profit on the rest of the capital would be

(30% x 500) x 2 = £300

As such, the total amount of his loss of profit would be [200 + 300 = £500]. In this example, the buyer will obtain the same amount whether by the profit of investment plus the recoverable damages or by the damages alone if he did not invest. However, the

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[50] F.L. Williamson, supra n.48 at p.731. Similar issue arises in cases of construction contract; where the owner's breach cause a delay in the performance of the construction contract, the contractor may lose a chance to earn elsewhere on contracting with others. If this becomes the case, the contractor may recover for the loss of such a profit. See I.N. Duncan Wallace, *Hudson's Building and Engineering Contracts*, London, Vol.1,11th ed., 1995 at p.1072.

[51] However, if the buyer put the part, which he did not invest, in a bank, the bank interest should be taken into account.

buyer in some cases may be required, under the mitigation principle, to put his capital for other available uses in order to minimize his loss.[52]

4.1.3 Goodwill and Loss of Prospective Profits

It is quite normal that a successful business is expected to have a continuity of profitable operations. Such expectation is what the concept of goodwill represents. Goodwill, in the normal course of circumstances, depends on many factors such as the name of the business, its history, the location and its commercial reputation.[53]

Where the goods are defective, the commercial reputation of the buyer's business may be affected. The commercial reputation can be represented by the average number of customers. If such a number decreases noticeably after the buyer's use of the defective goods, the buyer can be entitled to damages for the monetary loss he suffered due to the decrease in the demand on his products.

Under both English and American jurisdictions, the recoverability of damages for loss of goodwill seems to be well settled. Denying the recovery for loss of goodwill will be in a direct contradiction with the principle of *Robinson v. Harman.*[54] This is why in *GKN Centrax Gears Ltd v. Matbro Ltd.*[55] Lord Denning M.R. made it clear that the principle of *Hadley v. Baxendale*[56] applies to the loss of repeat orders of customers. His Lordship relied on the decision in *Aerial Advertising v. Batchelor's Peas*[57] where the plaintiff sent up an airplane advertising Batchelor's Peas. It flew on Armistice day, with a streamer bearing the words "Eat Batchelor's Peas". Many of the plaintiff's customers were very offended because the two minutes silence of the day was thus disturbed. As a result , the plaintiff lost repeat orders from the customers. The plaintiff was

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[52] For the mitigation principle, see infra p.298.
[53] The most famous definition of goodwill was stated by the Court of Appeal of Tennessee in *Young v. Cooper*, 1947 Tenn. App. LEXIS 70; 30 Tenn. App. 55 (1947) "The good will of a business is the reasonable expectation of its continued profitable operation. Many factors are involved: the name of the firm, its reputation for doing business, the location, the number and character of its customers, the former success of the business, and many other elements which would be advantageous in the operation of the business. Good will is a property right which may be sold."
[54] (1848) 1 Exch 850, 855. Supra, p.1.
[55] [1976] 2 Lloyd's Rep. 555.
[56] (1854) 9 Exch. 341.
[57] [1938] 2 All ER 788.

subsequently allowed damages for his monetary loss which resulted from the boycott to his products.[58]

The position under the UCC is quite identical. The leading UCC case on the recoverability of damages for loss of goodwill is *Hendricks & Associates, Inc. v. Daewoo Corporation*[59]. The facts of this case are, in brief, that the buyer (Hendricks & Associates, Inc.) purchased a quantity of "Stripe Collection" from a Korean company (Daewoo) in order to perform a subcontract with Champion, a wholesaler of sporting apparel. The buyer ordered the goods to be delivered directly to the sub-buyer. The goods appeared defective. Due to the buyer's liability to the sub-buyer, the buyer sued the seller for its losses resulting from the seller's breach. Our concern in this case is with the buyer's claim for damages for loss of prospective profits from anticipated future business with his sub-buyer (Champion). On appeal, after a long discussion of the restrictions imposed upon the recovery of such damages,[60] the United States Court of Appeals for the Third Circuit upheld the award of damages for such loss of profit. This case confirms that damages for loss of profit resulting from damage to the buyer's commercial reputation can be recovered under the normal restrictions imposed upon the recovery of damages.[61] The same conclusion can be reached under the CISG for two reasons. Firstly, Article 74 of the Convention awards damages for any loss resulting from the breach and meets the restrictions imposed by the Convention. Secondly,

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[58] In contrast, see the opinion of Lord Justice Scrutton in *Simon v. Pawsons and Leafs* [1932] 38 Com. Cas. 151, 157-8. In this case, under a sale contract, the defendant was obligated to deliver certain dress materials to the plaintiff in order to be used in making school uniforms. There was no contract between the plaintiff and the convent school, which appointed her to make the uniforms. The materials appeared defective. The Court of Appeal upheld the award for defective goods but refused to allow damages for loss of appointment and repeat orders. It is obvious in this case that the plaintiff suffered loss of reputation. It is unclear how the Court held that such a loss is too remote.

[59] 1991 U.S. App. LEXIS 269; 13 UCC Serv. 2d 1099 (1991). The first American case, where damages for loss of goodwill was awarded, was *Enoch C. Swain v. W. H. Schieffelin* 1892 N.Y. LEXIS 1539; 134 N.Y. 471 (1892) where the buyer who was a manufacturer of ice cream purchased materials for colouring of the ice cream which appeared defective. Many persons who ate cream made by the buyer, in which the said colouring matter had been used, were made sick with symptoms of arsenic poison. The Court of Appeal of New York allowed the buyer damages for loss of custom.

[60] The Court found that there was ample evidence that the restrictions of remoteness, mitigation, causation and certainty were satisfied.

[61] The recoverability of damages for loss of goodwill was traditionally not admitted in Pennsylvania. See R.P. Barbarowicz, 'Loss of Goodwill and Business Reputation as recoverable elements of Damages under Uniform Commercial Code § 2-715— The Pennsylvania experience' 75 *Dick. L. Rev.* 63, 65. Pennsylvania was the last State where damages for loss of goodwill was finally allowed. In *Franchise Assocs. v. Atlantic Richfield* Co., 1990 Pa. LEXIS 221; 14 UCC Rep. Serv. 2d 11 (1990) the claim for damages for loss of goodwill was allowed. See W.H. Henning and G.I. Wallach, *The law of Sales under the Uniform Commercial Code,* 1981, Supplement [1995] at p.10.05. See also *Step-Saver Data Systems, Inc. v. Wyse Technology,* 1990 U.S. App. LEXIS 14839; 12 UCC Rep. Serv. 2d 343 (1990) where the

Article 74 made specific reference to loss of profit in general. In this sense, loss of future profits can be recoverable.

The main obstacle facing the recoverability for loss of goodwill is the proof of such a loss. The buyer's pecuniary loss, in respect of damage incurred to the goodwill of the buyer's business, is constituted of loss of future profits. One should be well aware of the difficulty of ascertaining such a loss.[62] Methods of proof of loss of profit, such as an economist's or accountant's testimony, might not be enough to prove such a loss with reasonable certainty. These methods are more concerned with profits lost in fact. Future profits are more speculative which makes it harder for the buyer to prove their amount with reasonable certainty. However, "difficulty of proof should not dispense with necessity of proof."[63]

Supposing that the buyer presented tangible data to prove his loss of profit, the obstacle of determining the period for which damages should be quantified may arise. Theoretically, such a period should be wide enough to give the buyer the opportunity to remedy the dissatisfaction of his present and potential customers. Practically, such a period is too difficult to determine. The buyer, also, can claim damages for expenses he incurred or needs to incur in order to remedy such a dissatisfaction. In certain cases, the buyer's loss of goodwill may lead to the shutdown of his business. Such a severe consequence is very rare and can hardly be compensated due to the remoteness principle. Where the seller supplied defective products which appeared defective and as a result the buyer lost goodwill, it seems very hard to prove that it was in the reasonable contemplation of the seller, at the time of contracting, that loss of goodwill will cause a shutdown of business. However, this consequence can be ample evidence that the buyer suffered severe loss of goodwill. As a result, the buyer's damages for loss of goodwill may be increased due to such a severe consequence of the breach.[64]

United States Court of Appeals for the Third Circuit awarded the buyer the costs incurred in attempts to maintain its customers' goodwill.

[62] See *Agricultural Services Association v. Ferry-Morse Seed Company and Waldo Rohnert Company,* 1977 U.S. App. LEXIS 14129; 21 UCC Rep. Serv. 443 (1977).

[63] *Aerial Advertising v. Batchelor's Peas,* [1938] 2 All ER 788, 796 per Atkinson, J.

[64] In the UCC case of *Lewis River Golf, Inc. v. O.M. Scott & Sons,* 1993 Wash. LEXIS 48; 22 UCC Rep. Serv.2d 510 (1993) the Supreme Court of Washington awarded damages for loss of goodwill which caused a loss of business. The Court considered the shutdown of business for increasing the buyer's damages for loss of goodwill.

4.2 Certainty Requirement in Cases of Lost Profit

There are certain cases where the amount of economic loss can be proved with certainty such as expenses incurred as a result of breach. In such cases, the buyer is expected to show sufficient evidence of the amount of loss. The question becomes one of causation more than of certainty.[65] However, this may not be the case with lost profit. The amount of lost profit is hard to prove sufficiently certain. This is due to the fact that the circumstances of the market, such as fluctuation of prices and number of competitors, make it difficult to calculate what the buyer would have gained but for the seller's breach.[66] In discussing the requirement of certainty for the recovery of damages, we should consider two points, i.e. the fact of loss of profits and the amount of the loss. While certainty for the former is very significant, it is not for the latter.[67] In order to be allowed his loss of profit as damages, the buyer should show that he has suffered loss of profit resulting from breach of warranty of quality.[68] However, the court seems to be flexible regarding the certainty of lost profit as to its amount.

English and American courts seems to have similar attitude regarding the requirement of certainty in cases of long established businesses. In this case, the buyer may be required to present previous records of profit in order to prove his loss. In addition, the buyer may present any evidence of his lost profit. However, American courts seems to have different application of the certainty principle in cases of new business. They apply the "new business rule" which does not exist under English law. The following will start by dealing with the requirement of certainty in general and continue to deal with the adequacy of the "new business rule".

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[65] In *Davies v. Taylor* [1974] AC 207 Lord Reid, at p.213, said "[w]hen the question is or is not true- whether a certain thing did or did not happen- then the court must decide one way or the other. There is no question of chance or probability. Either it did or it did not happen. But the standard of civil proof is a balance of probabilities. If the evidence shows a balance in favour of it having happened, then it is proved that it did in fact happen."

[66] F.L. Williamson, supra n.48 at p.697.

[67] K.E. Kober, 'A Case for Recovery: Damages for Lost Profits of an Unestablished Business' (1979) 12 *Creighton L. Rev.* 1081, 1100; See *Kissel Co. v. Gressley,* 1979 U.S. App. LEXIS 17330; 591 F.2d 47 (9th Cir. 1979).

[68] In *Ratcliffe v. Evans* [1892] 2 QB 524 Bowen LJ, at pp. 532-533, pointed out that "[i]n all actions accordingly on the case where the damage actually done is the gist of the action, the character of the acts themselves which produce the damage, and the circumstances under which these acts are done, must regulate the degree of certainty and particularity with which the damage done ought to be stated and proved. As much certainty and particularity must be insisted on, both in pleading and proof of damage, as is reasonable, having regard to the circumstances and to the nature of the acts themselves by which the damage is done. To insist upon less would be to relax old and intelligible principles. To insist upon more would be the vainest pedantry."

4.2.1 Certainty as to Amount

The English court may not require the amount of loss to be proved sufficiently certain in order to entitle the aggrieved party to damages for such a loss. This can be the case where mathematical quantification is hard to be achieved such as the case of loss of goodwill. Where certainty cannot be achieved by mathematical precision, damages are still recoverable under both English and American law. In the leading case of *Chaplin v. Hicks,*[69] Vaughan Williams LJ stated that "the fact that damages cannot be assessed with certainty does not relieve the wrongdoer of the necessity of paying damages."[70] Indeed, damages have been allowed for losses which could only be valued impressionistically.[71] Here, it is worth noting that courts should not require substantially more information than the businessmen commonly use.[72] Requiring a high standard of certainty may make the recovery of loss of profit almost impossible.

The proof of loss of profit with reasonable certainty depends on the nature of the business. In most cases, the court allows the buyer to present any evidence, however minor, in order to prove his lost profit reasonably certain. However, in certain cases, the buyer may be required to show certain kinds of evidence. Established businesses mostly have previous records of profit which confer on the buyer a high chance of recovery. Previous records of profit can prove the amount of loss of profit with reasonable certainty.[73] Even where previous records show that the business was not profitable prior to the breach, such records may be of a great help to prove the greater loss resulting from the breach.

Where previous records are available, the buyer may recover damages calculated on the basis of the difference between his previous records of profit and the profit he gained by using the defective goods.[74] For example, if the average[75] of the previous records of the

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[69] [1911] 2 KB 786.
[70] Ibid at p.792.
[71] M.G. Bridge, supra. n.13 at p.450. Courts may allow damages for losses which cannot be proved with any degree of certainty as to its amount. See S.M. Waddams, 'Damages: Assessment of Uncertainties' (1998) 13 *JCL* 55, 60. In *Chaplin v. Hicks* [1911] 2 KB 786 Vaughan Williams LJ pointed out, at p.792, that "I do not agree with the contention that, if certainty is impossible of attainment, the damages for a breach of contract are unassessable."
[72] Comment, 'Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery' (1956) 65 *Yale L.J.* 992, 1018.
[73] Harvey McGregor, *Contract Code,* London, 1993, p.122.
[74] *Draft Systems, Inc. v. Rimar Manufacturing, Inc.* 1981 U.S. Dis. LEXIS 16779; 32 UCC Rep. Serv. 1493 (1981).

buyer's profit is £1000, the buyer's loss of profit will be calculated as follows. First, where the profit decreased to £600 due to the breach, the loss of profit would be [£1000-£600 = £400]. Second, where the business suffered a shutdown due to the breach, the buyer would probably be entitled to recover the whole profit recorded prior to the use of the defective goods, i.e. £1000.

Here, it should be emphasized that the profit in this context is the net profit. In other words, expenses wasted by the breach can be recoverable. Furthermore, where the buyer suffered expenses due to the breach, such expenses would be added to his lost profit.[76] In the hypothetical example mentioned, if the buyer incurred £100 as expenses due to the breach, he would, in principle, recover £500 in the first situation[77] and £1100 in the second situation[78].

Although the previous records of profit seem to be a tangible method of proving the amount of loss of profit with reasonable certainty, one should not deny the fact that loss of profit is hard to prove. The buyer finds it difficult to prove his loss of profit with reasonable certainty especially where the seller alleges that there were multiple causes for the buyer's loss of profit and his breach was not the principal one. This is likely to be the case where the profit of the business changes depending on various factors such as the economic and political situations of the place where the business is based. In this case, the seller will be required to show evidence that his breach was not the paramount cause of the buyer's loss of profit.

Under both English and American law, previous records of profit are not an exclusive method to satisfy the certainty requirement. Comment 4 on Section 2-715 of the UCC states that "... Loss may be determined in any manner which is reasonable under the circumstances." The buyer may seek to prove his loss of profit by other means such as

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[75] The average is considered to make the example clear. However, most of the businesses have special period of time in the year (the commercial season) when they can gain more than the other period of the same year. In this sense, if the buyer suffered loss of profit at this period, he might present the previous records of profit of this period of the past years of his work which will be higher than the average of the previous records of his profit.

[76] See the decision of the Supreme Court of Nebraska in the UCC case of *El Fredo Pizza, Inc. v. Roto-Flex Oven Company*, 1978 Neb. LEXIS 625; 23 UCC Rep. Serv. 342 (1978). The buyer may incur such expenses in his successful attempts to mitigate his potential loss of profit.

[77] Calculated as loss of profit in the first situation [400] plus the expenses incurred due to the breach [100].

[78] Calculated as loss of profit in the first situation [1000] plus the expenses incurred due to the breach [100].

expert testimony, market survey, evidence of the buyer's subsequent experience, evidence of the buyer's profits from similar business in other areas and records of profit of other similar business. Moreover, the buyer may seek to prove that the profit which he would have earned, but for the breach, exceeds the previous records of profit. This is to be expected where the buyer makes some modifications to his business which would have made his business more profitable but for the seller's breach. It is well known that the new businesses may face a difficult financial situation in the first few years while they are building up their commercial reputation. In this sense, the profit grows by the increase in the number of customers. If this becomes the case the profit of such businesses is likely to be greater than the profit earned by the same businesses in previous months or years.[79] Therefore, in such kinds of business, buyers may seek to prove their loss of profits by means other than the previous records of profits.[80]

In cases where the operation of a new business is delayed due to the seller's breach, the buyer may seek to prove his lost profit by presenting records of profit following the period of delay.[81] In principle, where the buyer could not start his business due to defective goods delivered by the seller, the buyer should be entitled to recover for his loss of profit resulting from the seller's breach. However, the proof of the amount of loss of profit with reasonable certainty is difficult.[82] As previously mentioned, businesses face difficult financial situations in the first period of their operations. In this view, it would be harsh for the buyer to prove that his business would have earned a profit but for the seller's breach. Nevertheless, where the buyer manages to show evidence that he suffered a loss of profit resulting from breach of warranty, it will become the duty of the court to quantify that loss according to the circumstances of the case.

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[79] R.R. Anderson, supra n.43 at p.406

[80] In certain cases, extra expenses caused by the breach can be seen as part of the loss of profit. So the court may not award the buyer for such expenses and loss of profit jointly. For example, in the UCC case of *El Fredo Pizza, Inc. v. Roto-Flex Oven Company* 1978 Neb. LEXIS 625; 23 UCC Rep. Serv. 342 (1978) damages for loss of profit were awarded in the form of award for the increase of labour's cost. The facts of this case are simply that the seller delivered a defective pizza oven. The labour's expenses increased by 7% since the buyer had to hire additional employees to make up for the insufficiency of pizzas caused by the defective oven. The Court awarded the buyer such extra expenses.

[81] K.E. Kober, supra n.67 at p.1100.

[82] In *Robert W. O'Brien et al. v. Floyd Larson et al.,* 11 Wash. App. 52 at p.99 it was held that lost profits proved with reasonable certainty are recoverable but prospective profits from a future business, whose costs are unknown, are too remote and speculative to be recoverable.

As for the CISG, Article 74 provides that damages consist of a sum equal to the loss. To determine the amount of damages, here, the buyer has to prove his loss of profit with reasonable certainty. Although it is well settled that the judge should be convinced by evidence that the buyer's lost profit is certain, the required degree of certainty as to the amount of lost profit is not stated by the Convention.[83] Theoretically, judges or arbitrators are unlikely to adopt a single standard of proof.[84] Practically, the degree of certainty as to amount is likely to be that degree required by the court, which has the jurisdiction, under the domestic law or that degree required by the domestic law that the arbitrator is most familiar with. Furthermore, Article 74 of the Convention may apply clearly to those pecuniary losses which can be mathematically measured. The words of the Article, however, make it difficult to tell how damages can be quantified in case of non-pecuniary losses and whether or not such damages can be recoverable under the Convention.[85]

4.2.2 The "New Business Rule" under American Law

The American courts, historically, used to be strict in the application of the requirement of certainty as to amount. This has resulted in the reluctance of the court to award for the loss of profit in general on the ground that the amount of loss of profit is hard to prove with reasonable certainty since the expected profit is normally too remote, speculative and uncertain. At the beginning of the twentieth century, the law in the US slightly changed to establish an exception to this rule. In the leading American case of *Central Coal & Coke Co. v. Hartman*,[86] the United States Federal Court for the Eighth Circuit stated that

> "the loss of profit from the destruction or interruption of an established business may be recovered where the plaintiff makes it reasonably certain by competent proof what the amount of his loss actually was... The interest upon his capital and the expenses of his business deducted from its income for a few months or years prior to the interruption produced the customary or yearly net profits of the business during that time, and form a rational bases from which the jury may lawfully infer what these profits would have been during the interruption if it had not been inflicted."[87]

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[83] See Peter Schlechtriem, supra n.7 at p.563.
[84] J.M. Lookofsky, 'Remedies for Breach of Contract' in L. Knapp, *Commercial Damages: A Guide to Remedies in Business Litigation,* 1986, Chapter 43, p.49.
[85] Infra, p.180.
[86] 111 F. 96 (8th Cir. 1901).
[87] *Central Coal & Coke Co. v. Hartman,* 111 F. 96 at p.99 (8th Cir. 1901).

The development in American law regarding this point resulted in a complete abandonment of such a strict requirement of certainty as to the amount of loss of profit. The amount of lost profit is not required to be proved with mathematical precision.[88] It is sufficient to prove such an amount with reasonable certainty. Comment 4 to Section 2-715 of the UCC states:

> "The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss..."

Where the buyer manages to prove his loss of profit with reasonable certainty, it will be sufficient for him to prove its amount *reasonably* certain.[89] In *Central Coal & Coke Co.* the Court stated that ".... He who is prevented from embarking a new business can recover no profits, because there are no provable data of past business from which the fact that anticipated profits would have been realized can be legally deduced."[90] In this case, the Court formulated the so-called "new business rule" under American law. The rule was made on the ground that records of profit that the business earns over the first period of its actual operation is unlikely to be sufficient enough to prove the amount of the loss of profit with reasonable certainty. This is due to the fact that the profit of the business in such a starting period of operation is, in the normal course of circumstances, changeable.[91] This rule does not apply to established business which has been in actual operation long enough to give it permanency and recognition.[92]

It should be clear that the American "new business rule" is an evidential matter. It is not a rule of law.[93] The distinction between established and new businesses is a matter of evidence only.[94] Therefore, in cases of new businesses where the buyer shows that the

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[88] In *Lexington Products, Ltd. v. B.D. Communications, Inc.,* 1982 U.S. App. LEXIS 19828; 677 F.2d 251 (1982) the United States Court of Appeals for the Second Circuit held that when it is certain that damages have been caused by a breach of contract, and the only uncertainty is as to their amount, there can rarely be any good reason for refusing on account of such uncertainty, any damages whatever for the breach.

[89] Denis Tallon, 'Damages, Exemption Clauses, and Penalties' (1992) 40 *Am. J. Comp. L.* 675, 678.

[90] *Central Coal & Coke Co. v. Hartman,* 111 F. 96 at p.99 (8th Cir. 1901). See M.D. Weisman and B.T. Clements, 'Protecting Reasonable Expectations: Proof of Lost Profits for New Businesses' (1991) 17 *Mass. L. Rev.* 186, 188.

[91] In contrast, see *Vogue v. Shopping Centers, Inc.,* 1978 Mich. LEXIS 398; 402 Mich. 546 (1978) where the Michigan Supreme Court considered the history of profit as a sufficient evidence to make the loss of profit reasonably proved.

[92] *Atomic Fuel Extraction Corp. v. Estate of Slick,* 1964 Tex. App. LEXIS 2859; 386 S.W.2d 180 (1964).

[93] K.E. Kober, supra n.67 at pp.1090-1.

[94] See *Systems Corp. v. American Tel. & Tel. Co.,* 1973 U.S. Dist. LEXIS 11732; 60 F.R.D. 692 (1973). See also *William Goldman Theatres, Inc. v. Loew's, Inc.,* 1948 U.S. App. LEXIS 4028; 164 F.2d 1021 (1948).

business had important orders or it was operating in an area of scarce supply, the "new business rule" should not apply.[95] Indeed, the Supreme Court of Alabama made it clear that the Court should focus on whether the plaintiff produced ample evidence instead of applying artificial categorization of new and old businesses.[96]

However, one may note that the "new business rule" is still strictly applicable by some courts. For example, in *Mehta v. Department of Consumer Affairs,*[97] damages for loss of profit were not allowed on the ground that the business was not in operation for a sufficient period of time. It seems difficult to understand why previous records are required where the buyer can prove his loss of profit by other means. Disallowing damages for loss of profit on the grounds that the business is new is in direct contrast with the purpose of awarding compensatory damages. In such a case, the buyer will be undercompensated by disallowing him damages for losses which he can manage to prove with reasonable certainty.

Furthermore, comment 2 to Section 2-708 of the UCC provides expressly that previous records of profit are not the only method of proof of loss of profit.[98] In this sense, where the buyer presents a sufficient evidence of his loss of profit, other than previous records of profit, such a loss is likely to be recoverable.[99] The seller may also seek to prove that there is no connection between the previous records of profit of the seller's business and

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[95] See *For Children, Inc. v. Graphics Int'l, Inc.*, 1972 U.S. Dist. LEXIS 10507; 11 UCC Rep. Serv. (Callaghan) 1176 (1972).

[96] *Super Valu Stores, Inc. v. Peterson,* 1987 Ala. LEXIS 4225; 506 So.2d 317 (1987). In this case, the Alabama Supreme Court held that "the weight of modern authority does not predicate recovery of lost profits upon the artificial categorization of a business as "unestablished," "existing," or "new" particularly where the defendant itself has wrongfully prevented the business from coming into existence and generating a track record of profits. Instead, the courts focus on whether the plaintiff has adduced evidence that provides a basis from which the jury could with "reasonable certainty" calculate the amount of lost profits...".

[97] 1991 N.Y. App. Div. LEXIS 7243; 556 N.Y.S.2d 601 (1991). In this case it was held that "in order to recover lost profits, a business must have been established and in operation for a definite period of time and calculations based on other similar businesses are too speculative and will not satisfy the reasonable means of calculating damages and lost profit."

[98] Section 2-708 provides "(1)... the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach. (2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale." Comment 2 on the Section provides that "It is not necessary to a recovery of profit to show a history of earnings, especially if a new venture is involved."

[99] F.L. Williamson, supra n.48 at pp.699-700.

the loss of profit caused by the breach.[100] For example, where an established business, with previous records of profits, moved to a new place or changed its brand name or moved into a new products line, the seller might allege that there is no connection between the profit of this business in its new place and its previous records of profit.[101] The place may affect the profit positively or negatively depending on the circumstances of each case. The same applies where a well known business expands to have a new branch in a new area.[102] The new branch should be considered as a new business. The previous records of profit of the business are unlikely to establish sufficient evidence of the loss of profit on the new branch.[103] But this should not be the case where the buyer adds a new line of production to increase the capacity of his factory. The history of profits of the buyer's factory should be a sufficient proof of his loss of profit.[104]

To sum up, although there seems to be a tendency towards relaxing the "new business rule", the rule is still influential in the American courts. It seems strange to decide that the business has not suffered loss of profit for the reason that it has no previous records of profit. The buyer should be allowed to prove his loss of profit by any available means. Therefore, it can be noted that English law deals better with the requirement of certainty.

4.3 Recoverability of Expenses Wasted or Caused by the Breach

In cases of breach of contract, the aggrieved party normally seeks to recover for loss of his expectation interest. However, in certain cases, the buyer may not be able to prove his loss of profit. In such cases, the buyer may seek to recover expenses incurred in reliance on the contract. In cases of retained defective goods, this can be the case where the goods appeared worthless due to their defect and the buyer did not suffer or cannot prove his loss of profit with reasonable certainty. In such a case, the buyer may seek to recover the capital expenses incurred in reliance on the contract. Furthermore, the buyer may also seek to recover extra expenses caused by the breach.

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[100] G.I. Wallach, 'the Buyer's Right to Monetary Damages' (1982) 14 *UCC L.J.* 236, 265.
[101] E.J. Wittenberg, 'the State of Lost Profits Damages and Punitive Damages for Breach of Contract in Pennsylvania' (1986) 6 *J. L. & Com.* 531, 539.
[102] See K.E. Kober, supra n.67 at p.1085.
[103] This is not an absolute rule. The buyer may seek to prove that the new branch has a similar situation to the other branch(s).
[104] K.E. Kober, supra n.67 at p.1092.

4.3.1 Recoverability of Expenses Wasted by the Breach

Two main points should be considered in a buyer's claim to recover, as damages, expenses wasted by the breach of contract. Firstly, where such expenses exceed the buyer's loss of gross earnings, will the buyer be entitled to recover such expenses? This can be the case where the buyer makes a bad bargain. Secondly, where the buyer incurs expenses, for the purpose of performance of the contract, before the time of making the contract, can he recover such expenses, as damages, in a contract action? To my knowledge, there are no cases of breach of warranty of quality dealing with such questions. Therefore, one needs to examine other cases of contract law in order to find the answers to such questions.

4.3.1.1 The Position in English Law

Under English law, the answer to the first question can be found in *C & P Haulage v. Middleton,*[105] where the Court of Appeal stated that the aggrieved party cannot be put in a better financial position than he would have been in if the contract had been performed properly. In this case, the Court decided that the plaintiff had made a bad bargain, as the expenses would not have been recoverable had the contract been performed. *Haulage* was referred to in *CCC Films (London) Ltd. v. Impact Quadrant Films Ltd.*[106] where Hutchison J. made it clear that "a claim for wasted expenditure cannot succeed in a case where, even had the contract not been broken by the defendant, the returns earned by the plaintiff's exploitation of the chattel or the rights the subject matter of the contract would not have been sufficient to recoup that expenditure."[107] It is obvious that the onus is on the defendant to prove that the plaintiff would not have been able to recover the expenses even if the contract had been properly performed.

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[105] [1983] 3 All ER 94. In this case, the plaintiffs sought to maintain a claim for the cost of work to premises from which he was later unlawfully evicted. The evidence established that the plaintiff was actually better off as a result of being evicted than he would have been had he been permitted to remain until the time when he could lawfully have been required to leave. It was held, at p.99, that "It is not the function of the Courts where there is a breach of contract knowingly, as this would be the case, to put the plaintiff in a better financial position that if the contract had been properly performed."

[106] [1985] 1 QB 16. In this case, the plaintiffs purchased from the defendants for $12,000 a license to exploit, distribute and exhibit three motion pictures. The defendants delivered taped recordings of the pictures, without which the license could not be used effectively. The tapes were handed back to the defendants in order to be sent to Munich. The defendants were required to arrange insurance and to send the tapes via recorded mail. The tapes were lost and the defendants were found in breach of the delivery contract and other subsequent contracts of delivery of replacements. The defendants did not show sufficient evidence that the plaintiffs would not have succeeded to recover their expenses had the tapes been delivered to them. The defendants were found in breach of the delivery contract and the other subsequent contracts. It was held that the plaintiffs were entitled to recover $12,000.

[107] Ibid at p.32.

In the aforementioned case of *CCC Films,*[108] the plaintiffs were entitled to recover, as damages, pre-contract expenses on the grounds that the loss of such expenses was foreseeable by the parties at the time of making the contract.[109] This leads to the question of whether pre-contract expenses are recoverable. In answering this question, English law seems to differ from American law. Under English law, the aggrieved party may recover pre-contract expenditure under the normal restrictions imposed upon the recovery of damages. This was held in *Anglia Television Ltd. v. Reed.*[110] In this case, Lord Denning MR said

> "If the plaintiff claims the wasted expenditure, he is not limited to the expenditures incurred *after* the contract was concluded. He can also claim the expenditure incurred *before* the contract, provided that it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken.... This decision is in accord with the correct principle, namely, that wasted expenditures can be recovered when it is wasted by reason of the defendant's breach of contract. It is true that, if the defendant had never entered into the contract, he would not be liable and the expenditure would have been incurred by the plaintiff without redress but the defendant, having made his contract and broken it, it does not lie in his mouth to say he is not liable, when it was because of his breach that the expenditure was wasted."[111]

Prior to the decision in *Anglia*, the general rule was that pre-contract expenses are not recoverable as damages. Exceptionally, conveyancing expenses incurred before the time of making the contract were allowed, as damages, before the decision in *Anglia.*[112] The exception was extended in *Lloyd v. Stanbury*[113] to allow the recovery of non-conveyancing expenditure which was required by the contract and made in anticipation of it. Ogus argues that in case of *Lloyd* there was no authority for the award of expenditure, incurred before the time of contracting, of performing an act required to be done by the contract. Anyhow, the exception was not widened enough to cover cases other than sale of land till the decision in *Anglia.*

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[108] *CCC Films (London) Ltd. v. Impact Quadrant Films Ltd* [1985] 1 QB 16.
[109] Ibid at p.40.
[110] [1972] 1 QB 60.
[111] Ibid at p.64. The case was referred to in *CCC Films (London) Ltd. v. Impact Quadrant Films Ltd* [1985] 1 QB 16.
[112] See *Wallington v. Townsend* [1939] 1 Ch. 588.
[113] [1971] 1 WLR. 535. The pre-contract expenditure claimed in this case was for the transportation and installation of a caravan on the site of the intended purchase before the time of making the contract. It was a term in the contract which required the plaintiff to provide such a caravan.

Clearly, pre-contract expenses are not part of the reliance interest. The party incurs such expenses in anticipation of making a contract and not in reliance on a contract. In *Perestrello and Companhia Limitada v. United Paint Co. Ltd.*[114] it was held that it is possible for the injured party to seek to recover his wasted expenses in order to be put in the position he would have been in if the contract had never been made; however, such expenses should not include expenses incurred before the time of making the contract. Most likely, in this case, pre-contract expenses were disallowed on the ground that they were consistent neither with expectation interest nor with reliance interest damages and therefore only nominal damages were recovered.

Ogus, in his comment on *Anglia,* concluded that "the award in [*Anglia*] is unsatisfactory in that it is consistent neither with reliance interest compensation nor with expectation interest compensation but reveals an unhappy confusion between the two.[115] Furthermore, Grinlinton argues that the award of such expenses represents a confusion between reliance interest and expectation interest damages."[116] Here, it should be noted that the terms 'reliance interest' and 'expectation interest' were first introduced by Fuller and Perdue in their interesting article on the reliance interest in contract damages, as explained at the beginning of this thesis.[117] However, there is nothing to suggest that a party cannot recover for a loss because such a recovery is inconsistent with the reliance interest compensation or the expectation interest compensation. McLauchlan makes it clear that "these terms [expectation and reliance interests] are merely aids to analysis, useful tools for determining the sorts of losses for which a plaintiff can normally recover in an action for breach of contract. There are certainly not overriding rules of law."[118] It is submitted that damages for wasted pre-contract expenses should always be recoverable under the normal restrictions imposed on the recovery of damages.

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[114] *The Times*, 16 April 1969. Cited in D.W. McLauchlan, 'Damages for Pre-Contract Expenditure' (1985) 11 *N.Z.U. L. Rev.* 346, 348.
[115] A.I. Ogus, 'Damages for Pre-Contract Expenditure' (1972) 35 *MLR* 423, 426. The decision in *Anglia Television Ltd. v. Reed,* [1972] 1 QB 60 was also criticized in A. G. Keesing, 'Pre-Contract Expenses — An Equitable Decision?' (1983) 9 *N.Z. Recent L. Rev.* 296.
[116] David P. Grinlinton, 'Damages for Wasted Expenditure in Contracts for the Sale of Land' (1984) 5 *Auckland U.L.R.* 37, 51.
[117] L.L. Fuller and William R. Perdue, Jr., The Reliance Interest in Contract Damages, (1936) 46 *Yale L.J.* 52. See supra, p.4.
[118] D.W. McLauchlan, supra n.114 at p.355.

In *Perestrello and Companhia Limitada v. United Paint Co. Ltd.,*[119] it was suggested that if at the eleventh hour the defendants had refused to conclude a binding contract, the plaintiffs would have had to bear the pre-contract expenses themselves. It is absolutely true that in cases where the defendant refuses to conclude a binding contract, the only action available to the injured party would be in restitution. It is unlikely that such an action will be helpful since restitution requires that a benefit is conferred on the other party. Certainly, the party who incurs such expenses will carry the risk of wasting them in cases where the contract is not concluded. However, this should not be the case after the conclusion of the contract. After the conclusion of the contract, the expenses may be wasted as a result of the breach of contract. Such expenses may be rendered futile if the contract is broken.

Corbin finds that pre-contract expenses should be irrecoverable on the ground that "they are caused neither by the breach of the contract nor by its making."[120] However, one may find that such expenses were wasted by the breach. If there was no breach, such expenses would not be wasted. Surprisingly, Ogus suggests that there is "no causal connection between the loss (the wasted expenses) and either the making of the contract and its breach."[121] It is clear enough that the pre-contract expenses can be wasted as a result of the breach. It seems unclear how Ogus does not see such a causal link. Plus, Ogus suggests that pre-contract expenses may be recoverable in cases where they were incurred after the parties had reached a substantial agreement, i.e. within the period between the substantial agreement and the formal contract.[122] Here, one finds it difficult to understand how Ogus can find the causal link between the breach and the loss, i.e. the wasted pre-contract expenses, in cases where substantial agreement was reached and cannot find such a causal link in other cases.

Personally, I cannot find a sufficient reason to deal with loss of pre-contract expenses differently. Such a loss is a kind of consequential loss. It results from the breach of contract. Therefore, if it was in the reasonable contemplation of the defendant, at the time of making the contract, that it is not unlikely to be wasted as a result of the breach, one may wonder why such expenses should not be recoverable. If such a loss is too

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[119] *The Times*, 16 April 1969.
[120] A.L. Corbin, *Corbin on Contracts,* Vol.5, 1964.
[121] A.I. Ogus, supra n.115 at p.425.
[122] Ibid, p.425.

remote, it will not be recovered as damages due to the application of the remoteness principle.

Furthermore, in cases where the plaintiff can prove that he suffered loss of profit, he may be allowed his loss of gross earnings [the buyer's expectations] minus the value he retains. As previously mentioned,[123] gross earnings are comprised of the net profit and the capital expenses. Pre-contract expenses are practically part of the capital expenses incurred by the plaintiff. There is no question about the recoverability of such expenses where they constitute part of the buyer's expectations. So, why should the recoverability be in question where the plaintiff seeks to recover the expenses he incurred?

4.3.1.2 The Position in American Law

As regards the first question, which is concerned with the recoverability of expenses that exceed the buyer's expectations, American law seems to have the same answer that can be found under English law. In *L Albert & Son v. Armstrong Rubber Co.*[124] where the United States Court of Appeals for the Second Circuit made it clear that damages should be reduced by the amount that the plaintiff would have lost if the contract had been fully performed.

However, American law seems to deal with the second question differently. Under all American jurisdictions, the recovery of pre-contract expenses is generally unavailable. However, in one American case, pre-contract expenses were exceptionally awarded for the reason that the contract was for an extension of a previous contract. This was the case of *French v. Nabob Silver-Lead Co.*[125] The case involved a dispute concerning a mining lease contract. The plaintiff had sought to obtain a two-year extension of the lease. The defendant informed the plaintiff that he would be unable to continue to provide compressed air for use in mining operations on the lease during any extension period. The plaintiff made an arrangement with another company for an alternative compressed airline. It is clear that the parties had reached a substantial agreement before the expenses where incurred in obtaining the alternative compressed airline and before concluding the formal contract of the lease extension. Later, the defendant breached the

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[123] Supra, p.92-3.
[124] 1949 U.S. App. LEXIS 2500; 178 F 2d 182 (1949). Cited in *C & P Haulage v. Middleton,* [1983] 3 All ER 94, 98.
[125] 350 P.2d 206 (1960).

contract and the defendant sought to recover the wasted expenses including the pre-contract expenses. The Idaho Supreme Court allowed the plaintiff all the expenses wasted by the breach including his pre-contract expenses. The decision in this case seems to support the view of Ogus mentioned above.

However, the case of *French* does not represent the general attitude of the American courts. In most cases, the courts were reluctant to allow the pre-contract expenses on the ground that they were not incurred in reliance on the contract.[126] Most likely, *French's* case was decided differently due to its special facts. The contract was an extension of previous contract which had the same subject-matter. In another case, pre-contract expenses were not allowed although they were incurred after the general agreement was reached and before the final contract was signed.[127] The general rule under American law regarding pre-contract expenses is summarized as follows:

> "For expenditures incurred before the actual making of the contract, a *defendant is not liable unless he is affirmatively shown to have assumed responsibility for them.* The action is based upon the contract and can include only losses sustained as a consequence of it. The rule applies even if the expenditure were incurred directly for the purpose for which the plaintiff made the contract...."[128] [Emphasis added]

A comparison between English law and American law shows that the latter is less favourable for the plaintiff. As previously mentioned, pre-contract expenses comprise part of the buyer's gross earnings [the buyer's expectations]. As the buyer's lost expectations can be recovered under the normal restrictions imposed on the recovery of damages, there seems no point to prevent the recovery of pre-contract in cases where they are claimed alone. The approach of the American courts regarding this issue is in direct contradiction with the objective of damages. Under the UCC, damages must be awarded for the actual losses suffered by the buyer as a result of the seller's breach. In

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[126] See *Hough v. Jay-Dee Realty and Investment Inc.* 1966 Mo. App. LEXIS 681; 401 S.W.2d 545 (1966) where the defendant breached its contract to construct and then lease to the plaintiff a restaurant building. It was held that expenses incurred within the period of negotiations are irrecoverable since they were not referable to the contract or its breach. See also *Gruber v. S-M News Co.* 1954 U.S. Dist. LEXIS 2498; 126 F. Supp. 442 (1954); *Gordon v. Pfab,* 1976 Iowa Sup. LEXIS 1247; 246 N.W.2d 283 (1976); *Norton & Lamphere Construction Co. v. Blow & Cote, Inc.* 1962 Vt. LEXIS 210; 183 A.2d 230 (1962). In the last case, the pre-contract expenses were disallowed on the ground that they were not known to the defendant (a buyer of crushed rock) at the time of making the contract. The pre-contract expenses were not disallowed on the ground that they do not refer to the contract or its breach. See G.S. Crespi, 'Recovering Pre-contractual Expenses as an Element of Reliance Damages' (1995) 49 *South Methodist University Law Review* 43, 61.

[127] *Chicago Coliseum Club v. Dempsey* 1932 Ill. App. LEXIS 805; 265 Ill. App. 542 (1932).

[128] 17 A.L.R. 2d at 1314; cited in D.W. McLauchlan, supra n.114 at n.25.

view of that, it can be noted that English law is better than American law regarding the recoverability of pre-contract expenses.

4.3.2 Expenses Caused by the Breach

The buyer may incur extra expenses due to the seller's breach of warranty of quality such as fines, costs of litigation, costs of examination, extra labour expenses and cost of cure. The recoverability of some of these expenses has been previously examined.[129] The buyer may also save expenses which would have been incurred if the goods had been free of defects. For the latter, it is previously stated that such expenses should be deducted from the total recoverable damages where the manufacturer buyer saved expenses due to the deficiency of the productive capacity of the delivered goods.[130]

As regards examination costs, under English law, such cost of inspection is likely to be considered as cost of litigation. However, under the UCC, the examination costs can be recovered as damages. Section 2-513 of the UCC states that inspection expenses "must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected". The word for word reading of this section suggests that the buyer will not be able to recover such expenses unless he rejects the goods. It is still debatable whether or not the buyer can recover expenses incurred on special inspection required to examine the defective goods after the acceptance.

To avoid this confusion, it is best to distinguish between two types of inspection: first, inspection which occurs prior to the rejection or acceptance of the goods. Expenses incurred on such an inspection would be considered as incidental loss if the buyer rejected the goods. However, if the buyer, despite the fact that the goods are defective, decided to accept the goods, he would not be able to recover such expenses since awarding such damages contradicts Section 2-513 of the UCC. Second, inspection which occurs after the acceptance of the goods. This inspection normally occurs to examine goods discovered defective after the acceptance in order to find out what part of the goods is defective. The costs of the second type of inspection in cases of breach of warranty of quality should be recoverable whereas costs of the first type should not. The second type of inspection is not within the words of Section 2-513 of the UCC since the

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[129] For the cost of cure, see supra 75.

Section is implicitly concerned with inspections occurring prior to the time of acceptance or rejection of the goods. In the UCC case of *Safeway Stores, Inc. v. L. D. Schreiber Cheese Co.*[131] the Court awarded the expenses incurred on the inspection of ten million pounds of cheese. In this case, the buyer inspected the goods in order to find out which of the cheese was contaminated.

In fact, it is better to deal with such costs as litigation costs in order to encourage the parties to set for settlement. Under English law, if one party refuses to set for settlement, he will not be able to recover the cost of litigation and as a result he will not be able to recover the cost of examination. Such cost of examination is incurred after the buyer discovers the seller's breach. The examination is carried out for the purpose of the buyer's claim against the seller. Therefore, it is more realistic to deal with them as cost of litigation.

Other expenses, such as fines paid due to the defective quality of goods, may be recoverable in principle. Where it was in the reasonable contemplation of the parties, at the time of making the contract, that it is unlikely that the buyer will be prosecuted if the seller delivers defective quality goods, the buyer could recover, as damages, fines paid and expenses incurred in defending prosecution provided that the concept of *mens rea* did not arise. However, where it is shown that there was on the part of the person a degree of *mens rea*, the buyer will not be able to recover the fine paid or expenses incurred in defending the prosecution.[132] Where the prosecution failed and the buyer was not fined, he may be entitled to recover the expenses incurred in defending the prosecution as damages from the seller.[133]

As for cost of litigation, the general rule under English law seems to allow the buyer what he spent in successfully suing the seller including the lawyer's fees. However, the position under American law is different. The general rule in the USA is that the buyer can only recover the attorney's fees, in an action for breach of contract, only if there is

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[130] See loss of use, supra p.128..

[131] 1971 U.S. Dist. LEXIS 13606; 9 UCC Rep. Serv. 407 (1971).

[132] *Osman v. J. Ralph Moss,* [1970] 1 Lloyd's Rep. 313. The recovery of the fine from the defendant was not clear before this case, especially where the concept of *mens rea* does not come into picture. On this point, see the following cases *Crage v. Fry* [1903] 67 *J.P.* 240, *Cointat v. Myham* [1913] 2 KB 220, *Leslie v. Reliable Advertising Agency* [1915] 1 KB 625.

[133] Harvey McGregor, supra n.27 at p.599.

an express term in the contract or where a statute authorizes such a recovery.[134] However, several States do not apply this rule and do authorize the recovery of such fees as damages for breach of contract. In addition, a number of consumer protection statutes authorize such a recovery.[135] It seems that the buyer would be undercompensated by not entitling him to recover what he spent as attorney's fees.

Conclusions

Due to the failure to distinguish between net profit and gross earnings, the court may fail to achieve the objective of damages, as stated in *Robinson v. Harman,*[136] by placing the buyer in a better or less favourable financial position than the position he would have been in if the goods had been delivered as warranted. In other words, the failure to distinguish between net profit and gross earnings may overcompensate or undercompensate the buyer. The classification stated in *Cullinane v. British "Rema" Manufacturing Co. Ltd.*[137] should only apply where the buyer seeks to recover his lost gross earnings and the capital expenses wasted by the seller's breach. Indeed, the buyer can either claim his lost gross earnings or the capital expenses since the latter is part of gross earnings. However, in principle, the buyer may be entitled to recover his lost net profit and the capital expenses. In fact, the buyer's expectations are comprised of the capital expenses and the net profit. If the goods delivered are valueless, the buyer may be entitled to all his expectations. By doing so, the buyer will be put in the same position he would have been in had the goods been delivered as warranted. In other words, the award will comply with the principle of *Robinson.* In *Cullinane* the court failed to achieve the objective of damages stated in *Robinson.* The Court in *Cullinane* held that the buyer may claim either his capital expenses or his loss of profit. It is submitted that the rule of *Cullinane* can only apply where the buyer claims his lost gross earnings and capital expenses.

In cases of profit making goods, the objective of damages, as stated in *Robinson,* can be achieved by allowing the buyer damages calculated on the basis of the difference between the actual net profit that the buyer has gained and the net profit that the buyer

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[134] G.I. Wallach, supra n.100 at p.276.
[135] Ibid at n.120 where examples of such statutes are cited.
[136] (1848) 1 Exch 850.
[137] [1954] 1 QB 292.

would have gained if the goods had been delivered as warranted. Net profit in such a case can be quantified under the following formula:

> (*the total earning of the goods during their commercial life + the residual value of the goods at the end of their commercial life*) *less the contract price of the plant and any further expenses incurred in reliance on the contract.*

Moreover, the principle of *Robinson* cannot be properly applied in cases of profit-making goods without considering the buyer's loss of the chance of investing the annual earnings that he would have obtained but for the seller's breach. This work provided a way of quantifying the buyer's damages for such a loss of chance. Where the defective goods cause a delay in operation of the buyer's business and the buyer, as a result, releases his capital for other profitable use, the following formula may apply.

> {[(*total expected percentage on return on capital - the percentage on actual return*) *x* (*capital investment*)] *x number of years of recovery period.*}

Nevertheless, allowing the buyer damages under the principle of *Robinson* may overcompensate him in cases where the buyer has mitigated his loss. Therefore, the buyer may not recover damages under the mentioned formula where he has mitigated, or could have mitigated, his loss by obtaining substitute goods or repairing the goods. In such a case, the buyer's damages will be calculated on the basis of the cost of replacement or repair as explained in the previous chapter. The court should ensure that the buyer will not be overcompensated by applying the principle of *Robinson.* Where the buyer stopped using such goods in order to mitigate his loss, he would recover for the loss of net profit during the period of using the machine. Plus, he would be entitled to recover for his loss of gross earnings for the remaining period of the commercial life of the machine after subtracting the running expenses which were supposed to be incurred if the machine operated as warranted. The application of the mitigation principle depends on the circumstances of each case. For example, where the deficiency in the productive capacity is trivial, the buyer may mitigate his loss by continuing to use the defective goods.

Loss of profit can generally be suffered through loss on resale, loss of use and loss of goodwill. Loss of profit on resale can normally be quantified as the difference between the resale price and the contract price. This formula can apply only where it is

unreasonable to enforce subcontract by delivering the goods in question or where the sub-buyer rejects them due to their defect. As regards the buyer's commercial reputation, loss of profit resulting from the damaged commercial reputation are recoverable under the SGA, the UCC and the CISG. Indeed, the objective of damages cannot be achieved if such a loss is ignored. Commercial reputation can be represented by the average number of customers. The difficulties of proof and quantification may face the buyer's claim for damages for loss of commercial reputation. The period for which such damages are assessed should be long enough to give the buyer the opportunity to remedy the dissatisfaction of his present and potential customers. The buyer may also claim the cost of remedying such dissatisfaction.

The methods of quantifying damages developed in this chapter should apply similarly under the SGA, the UCC and the CISG. The buyer's damages should not exceed his actual loss. The methods of quantification of damages developed in this chapter are concerned with the principle of *Robinson* taking into account the normal restrictions imposed on the recovery of damages, i.e. causation, remoteness, mitigation and certainty. The principle of certainty is mostly concerned with loss of profit. In general, it is the duty of the buyer to prove the loss of profit with reasonable certainty. Whereas the uncertainty of the fact of loss of profit is fatal, it is not as to the amount of loss of profit. Difficulty of quantification of loss should not dispense with its recoverability.

American law, in comparison with English law, seems to have a strict application of the principle of certainty. The "new business rule" is applied in order to disallow damages for loss of profit in cases of new business. However, it was argued that such a rule should be considered as a rule of evidence which should be displaced where the buyer can prove his loss of profit. It has been seen how the strict application of such a rule has lead in some cases to unfair results. It is clear that English law seems to have a better application of the principle of certainty. The "new business rule" does not exist under English law. The certainty of lost profit depends on the evidence presented by the buyer regardless of whether the business is new or has long been established.

English and American courts seem also to disagree regarding the recoverability of pre-contract expenses. In certain cases the buyer may prefer to claim only the expenses wasted by the breach. Under English law, it seems that such expenses include pre-

contract expenditure. In principle, wasted pre-contract expenses are recoverable under the normal restrictions imposed upon the recovery of damages. The position is different under American law. The general attitude of the American courts is that pre-contract expenses are not recoverable on the ground that they are not incurred in reliance on the contract. Such an attitude is supported by respected writers such as Ogus. However, it has been argued that the reasoning of the American courts is not sufficient to deny the recoverability of such expenses. Pre-contract expenses can be wasted by the breach and, therefore, the causation requirement is satisfied. Furthermore, it has been explained how such pre-contract expenses constitute part of the gross earnings [the buyer's expectations]. Therefore, it is unclear why wasted pre-contract expenses should not be recoverable while loss of gross earnings as always recoverable under the normal restrictions imposed upon the recovery of damages. It is submitted that the attitude of English law regarding this matter is to be preferred to the American one.

Chapter Five

Seller's Liability for Physical Damage: Recoverability of Damages for Non-Pecuniary Loss

> "To compensate in money for pain and for physical consequences is invariably difficult but it is recognised that no other process can be devised than that of making a monetary assessment. No sort of arithmetical calculation is possible...".[1]

> "Some objects have a special value to their owner, far in excess of their commercial worth: pets, heirlooms, photographs, letters, souvenirs or works of personal creation. Other objects have no great sentimental value, but are vital to a person's enjoyment or peace of mind: a motor caravan hired for a family holiday or a morning suit ordered for a wedding."[2]

Introduction

Under the principle of *Robinson v. Harman*,[3] the buyer is entitled to recover for losses caused by the defective goods in order to be placed, so far as money can do it, in the same position as if the goods had been delivered as warranted. However, monetary award may not remedy the buyer's non-pecuniary damage. The buyer, who suffers personal injury or disfigurement due to the defective goods, may not be relieved by receiving an amount of money under the principle of *Robinson*. In fact, the application of the principle of *Robinson* may provide relief in cases of financial loss more than in cases of personal injury. However, monetary award seems to be the only available remedy for the buyer's damage. Indeed, the statement of Parke B in *Robinson* indicates that monetary award may not always place the aggrieved party in the same position he would have been in if the contract had been properly performed. In principle, the buyer should be compensated for all losses he suffered due to the seller's breach of warranty of quality.

Nevertheless, English courts seem to disallow damages for certain types of loss resulting from the seller's breach. Under English law, damages are generally unavailable for

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[1] *Parry v. Cleaver* [1970] AC 1, 22 per Lord Morris.
[2] Norman Palmer and Ewan McKendrick, *Interests in Goods,* London, 2nd ed., 1998, p.867.
[3] (1848) 1 Exch 850, 855.

disappointment, distress, frustration, anxiety, displeasure, vexation and tension resulting from a breach of contract. In certain cases, such types of damage may result from the defective quality of goods. It will be argued that the general non-recoverability rule is in direct contradiction with the purpose of compensatory damages in contract law, as stated in *Robinson.* The issue will be dealt with in relation to the recent decision of the House of Lords in *Malik v. BCCI.*[4] Furthermore, English courts seem to have no coherent attitude regarding the general non-recoverability rule. Nevertheless, there are certain cases where the general non-recoverability rule does not apply. Such cases will be examined in order to see whether or not cases of defective goods fall within their scope.

In comparison with American law, one may note that neither English law nor American law has gone far enough to allow damages for all non-pecuniary losses under the normal restrictions. American courts do not have coherent attitude regarding the recoverability of damages for certain types of non-pecuniary loss. The attitude of the courts varies among the several States of the USA. In fact, the UCC provides that the buyer is entitled to recover for the losses he suffered due to the seller's breach. However, American courts seem to rely on the Restatement (Second) of Contracts which exceptionally allows damages for non-pecuniary losses in certain cases. It will be argued that there seems to be no reason to deal with certain types of non-pecuniary losses differently. Damages should be available for all types of loss under the normal restrictions imposed on the recovery of damages.

As regards damages for physical loss,[5] the recoverability of such damages is commonly a question of tort. However, the buyer may bring a contract action for physical loss resulting from a breach of contract. Indeed, ignoring losses resulting from a breach of contract can be in contradiction with the objective of damages stated in *Robinson.* Under both English and American law, where physical loss results from a breach of contract, the aggrieved party may have the choice to sue in contract, tort or both for the same loss. The buyer who brings a tort action under the Consumer Protection Act 1987, need not prove negligence. In view of the fact that damages for physical loss can be recoverable in a tort action, one may need not go through lengthy examination of the recoverability of such damages in contract. Anyhow, where the contract action is available, the buyer

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[4] [1998] AC 20.

[5] For the sake of simplicity, the term "physical loss" is used to include both personal injury and damage to property other than the goods supplied.

should take into account the remoteness restriction in his choice to sue in contract or tort. Under English law, the remoteness principle applies in tort and contract differently. It is intended to argue that such a difference in application may lead to unfavourable results. Under the UCC, the remoteness principle does not restrict the recoverability of damages in cases of physical loss. The issue of whether this can be a suitable approach cannot be avoided.

Although this thesis is mainly concerned with the quantification of damages under the principle of *Robinson*, it seems necessary to consider whether damages can be recovered for all types of loss under the SGA, the UCC and the CISG. In general, damages for all types of physical loss can be claimed under the SGA and the UCC. However, this may not be the case under the CISG. Under the CISG, the buyer may be unable to sue for certain physical losses resulting from breach of warranty of quality. If this becomes the case, the buyer needs to sue under the applicable domestic law. It is intended to examine the recoverability of damages for physical loss under the CISG. Furthermore, this chapter considers whether the buyer can avoid the application of the CISG by bringing an action in tort under the applicable domestic law.

5.1 Lord Denning's View Regarding the Remoteness Restriction[6]

As the buyer may have the choice to sue in contract or tort for physical loss, it seems necessary to see whether the remoteness principle applies in tort and contract differently.[7] The difference in the application of the remoteness principle in tort and contract may lead to a difference in the outcome. Remoteness principle is one of the principles that may restrict the buyer's recovery under the principle of *Robinson v. Harman*.[8] If the application of the remoteness principle substantially reduces the buyer's damages under the principle of *Robinson,* the buyer may prefer to bring an action in tort in order to be placed in the same position before the physical loss occurred. In contract law, under the remoteness principle, recoverable damages should normally be for detriments that are in the reasonable contemplation of the parties, at the time of contracting, as not unlikely to result from the breach.[9] However, the principle applies in

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[6] For the Remoteness restriction, see infra p.284.
[7] In *Henderson v. Merrett Syndicates Ltd* [1995] 2 AC 145, the House of Lords made it clear that the innocent party may be entitled to sue in tort and contract for the same loss.
[8] (1848) 1 Exch 850, 855. Supra, p.1.
[9] *C. Czarnikow Ltd.v. Koufos (Heron II)* [1969] AC 350.

tort differently. It provides that "the defendant will be liable for any type of damage which is reasonably foreseeable as liable to happen even in the most unusual case, unless the risk is so small that a reasonable man would in the whole circumstances feel justified in neglecting it."[10] In principle, where the remoteness principle arises, the buyer will have a better chance of recovery in tort than in contract.

It seems that there is an emerging distinction between economic loss and physical loss regarding the application of the remoteness principle. In the famous case of *Parsons (Livestock) Ltd v. Uttley Ingham & Co.*,[11] Lord Denning M.R. suggested that in cases of physical loss, the remoteness principle should apply in tort and contract similarly.[12] The facts of this case can be summarized as follows. The plaintiff, who was an owner of a herd of pigs, bought a hopper to store special pignuts. After using the hopper for a period of time, some of the pignuts appeared mouldy. Due to that, a large number of pigs died. At first instance, it was held that the plaintiff was entitled to damages for his loss under Section 53(2) of the SGA and stated that the remoteness principle does not restrict the recovery under this section. The Court of Appeal approved the award but on different grounds. The Court of Appeal applied the remoteness principle to such a recovery. Scarman LJ, with whom Orr LJ apparently agreed,[13] found that the loss, i.e. the death of the pigs, the plaintiffs' expenses in dealing with the infection and loss of sale and turnover, was in the contemplation of the parties at the time of making the contract as a *serious possibility* to result from the breach.[14]

However, Lord Denning M.R. took a different view regarding the application of the remoteness principle. He pointed out that where an action could be brought in tort and contract for the same loss, the remoteness principle should apply to contract and tort similarly.[15] As the tort action can be available in cases of physical loss, Lord Denning M.R. drew a distinction between physical loss on the one hand and economic loss on the

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[10] Ibid at p.387. See also *Overseas Tankship (U.K.) Ltd. v. Miller Steamship Co.*, [1967] AC 617; *Horne v. Midland Railway Co.* [1872] 7 C.P. 583.
[11] [1978] 1 QB 791, 801.
[12] Ibid at p.802.
[13] Ibid at p.804.
[14] Ibid at pp.809-813.
[15] In this case Scarman LJ, at p.806, pointed out that "I agree with [Lord Denning M.R.] in thinking it is absurd that the test of remoteness of damage should, in principle, differ according to the legal classification of the cause of action, though one must recognize that parties to a contract have the right to agree on a measure of damages which may be greater, or less, than the law would offer in the absence of agreement." However, Scarman LJ did not apply this distinction to the case since he found that previous cases do not support this opinion.

other. Regarding cases of physical loss, he stated that, "the defaulting party is liable for any loss or expense which he ought reasonably to have *foreseen* at the time of the breach as a possible consequence, even if it was only a *slight* possibility."[16] In fact, the requirement of "slight possibility" applies normally in tort and not in contract. In other words, Lord Denning M.R. applied the remoteness principle to the recovery of damages for physical loss resulting from a breach of contract in the same way that it applies in tort.

Lord Denning M.R. went on to provide examples that support his view. The obvious example is concerned with "string contracts".[17] "In many of these cases the manufacturer is liable in contract to the immediate party for a breach of his duty to use reasonable care and is liable in tort to the ultimate consumer for the same want of reasonable care."[18] In this example, it seems that there is no point of applying the remoteness principle in tort and contract differently. The ultimate buyer can claim damages from his direct seller in a contract action and pass the liability up the chain to reach eventually the manufacturer; alternatively, he may sue the manufacturer directly in tort.[19] Here, if the ultimate consumer chose to sue his direct seller in a contract action and the loss was in their contemplation, at the time of contracting, as a *slight possibility* to result from the breach, the seller would not be liable and ultimately the manufacturer would escape liability.[20] However, if the ultimate consumer sues the manufacturer in tort, the manufacturer may be liable.[21] In fact, one finds it hard to accept that

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[16] *Parsons (Livestock) Ltd v. Uttley Ingham & Co.,* [1978] 1 QB 791, 803

[17] In this work, there seems no room to examine other examples which are not concerned with sale of goods contracts. For such examples, see J.M. Steiner, 'A Question of Remoteness' (1978) 29 *N.I.L.Q.* 282, 287.

[18] *Parsons (Livestock) Ltd v. Uttley Ingham & Co.,* [1978] 1 QB 791, 803.

[19] Where the goods were determined not defective in tort, the plaintiff would not lose the right to sue in contract under the warranty theory. Where the claim is in contract, deciding whether the goods are defective or not should be held in the light of the express warranty or/and implied warranties stated by the contract or the statute. See R.E. Speidel, 'Warranties of Quality in Revised Article 2, Sales and the Convention on Contracts for the International Sale of Goods' (1999) 14 *JCL* 15. See also J. M. Feinman, 'Implied Warranty, Product Liability, and the Boundary between Contract and Tort' (1997) 75 *Wash. U. L. Q.* 469, 470 (citing *Denny v. Ford Motor Co.,* 662 N.E.2d 730 (N.Y. 1995) where the court found the seller in breach of warranty of quality although he was not liable under the tort claim of the aggrieved party.

[20] The statute limitation period or the warranty period might be longer or shorter than the period during which the buyer can sue in tort. In this sense, in the buyer's point of view, there is a competition between tort and contract for finding the best outcome.

[21] In string contracts, there is normally no direct contract between the ultimate buyer and the manufacturer. Here, the privity restriction may prevent a party who is not privy to the contract to sue for breach of the contract. See J.J. White and R.S. Summers, *Uniform Commercial Code*, 4th ed., West Publishing Co., 1995, 384. However, in certain cases, the privity restriction may not prevent the ultimate buyer's action in contract against the manufacturer. See chapter six, infra 198.

determining the liability of the manufacturer depends on the action that the ultimate consumer brings.

Lord Reid in *Heron II* justified the difference in application of the remoteness principle in tort and contract on the ground that a party to a contract can protect himself against a risk which would appear unusual to the other party by directing the other party's attention to it before the contract is made while there is no such an opportunity for the injured party in tort to protect himself.[22] In fact, I find it difficult to understand such a justification in cases where the buyer has the choice to sue in tort or contract for the same loss. Here, one can point out that it does not seem fair, at all events, that the availability or the *quantum* of damages may differ depending on whether the action is brought in tort or in contract.[23] Until now, to my knowledge, there are no cases supporting the equality of the application of the remoteness principle in tort and contract regarding physical losses; but it is hoped that the law will develop in the direction which leads to such equality.

A supportive view can be found in American law. Under American law, the difference in action for physical loss does not lead to a difference in the outcome. In cases of physical loss, the same restrictions apply in tort and contract. Section 2-715(2-b) of the UCC adopts the causation standard of tort. The section provides that "Consequential damages resulting from the seller's breach include... injury to person or property proximately resulting from any breach of warranty." In this sense, under the UCC, damages for physical loss can be recoverable, regardless of whether or not it was foreseeable at the time of contracting, as long as such a loss results from a breach of contract.[24] The attitude of the UCC may be understood on the grounds that "public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market."[25]

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[22] *C. Czarnikow Ltd.v. Koufos (Heron II)* [1969] AC 350, 386.

[23] See Hadjihambis, 'Remoteness of Damage in Contract' (1978) 41 *MLR* 483, 485 where the commentator suggests that the distinction drawn by Lord Denning involves an emphasis on the difference rather than the reconciliation of the remoteness test in contract and tort.

[24] R.R. Anderson, 'Incidental and Consequential Damages' (1987) 7 *J. L. & Com.* 327, 461; Eric C. Schneider, 'Consequential Damages in the International Sale of Goods: Analysis of Two Decisions' (1995) 16 *U. Pa. J. Int'l Bus. L.* 615, 633. See also *Kinsman Transit Co. v. Midland S.S. Line, Inc.*, 1964 U.S. App. LEXIS 4032; 338 F.2d 708 (2d Cir. 1964).

[25] *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 1986 U.S. LEXIS 57; 1 UCC Rep. Serv. 2d 609 (1986). See T.A. Diamond and H. Foss, 'Consequential Damages for Commercial Loss: An Alternative to *Hadley v. Baxendale'* (1994) 63 *Fordham L. Rev.* 665, 679.

Although the UCC ignores expressly the application of the remoteness principle to the recovery of damages for physical loss, the courts in some cases did apply the remoteness principle to such a recovery. In *Lidstrand v. Silvercrost Industries*,[26] the plaintiff suffered the loss of his clothes and belongings as a result of a defective mobile home. The Court awarded damages for this consequential loss on the ground that the seller had reason to know, at the time of making the contract, that such a loss could result from the general use of the defective goods.[27] However, the application of the remoteness principle to the recovery of damages for physical loss seldom happens. It can be noted that in the USA the remoteness principle does not restrict the recoverability of damages for physical loss.[28]

In comparing English law with American law, one may note that the latter is more generous in allowing damages for physical loss. It seems that the buyer under American law has better chance to recover for physical loss than under English law. This is due to the fact that the remoteness principle does not apply to cases of physical loss under the UCC. Damages for physical loss, under the UCC, can be recovered as long as such damages are *approximately caused* by the breach and both the mitigation and certainty restrictions are satisfied. However, it should be noted that in practice the remoteness principle has rarely prevented the recovery for physical loss under the SGA.[29] Nevertheless, ignoring the application of the remoteness principle to the recovery of damages for physical damage may lead to an unlimited liability of the seller in cases of physical loss. It is submitted that remoteness principle should apply to all losses resulting from breach of contract. However, where the breach causes physical loss, the remoteness principle should apply in contract and tort similarly.

5.2 The Recoverability of Damages for Physical Losses under the SGA and the UCC

As mentioned at the beginning of this chapter, there seems to be no point to go through lengthy examination of the recoverability of damages for physical losses since such

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[26] 1981 Wash. App. LEXIS 1999; 31 UCC Rep. Serv. 978 (1981).
[27] R. R. Anderson, supra n.24 at p.453. See also *Griese v. Cory Pools, Ltd.*, 1978 Ill. App. LEXIS 2289; 23 UCC Rep. Serv. 1195 (1978).
[28] Eric C. Schneider, supra n.24 at p.633. G.I. Wallach, 'the Buyer's Right to Monetary Damages' (1982) 14 UCC L. J. 236, 280; R. R. Anderson, supra n.24 at p.452; Special Project, 'Article Two Warranties in Commercial Transactions' (1978) 64 *Cornell L. Rev.* 30, 147.

damages can also be claimed in tort. Nevertheless, one may need to consider certain points that may arise in cases of physical losses. The general rule is that the aggrieved party is entitled to recover for his actual losses resulting from a breach of contract. This must be decided in accordance with the normal restrictions imposed on the recovery of damages. Therefore, although the purpose of damages, as stated in *Robinson v. Harman,*[30] may not be achieved due to the nature of the damage, e.g. personal injury and disfigurement, damages can still be awarded as it is the only way to compensate the aggrieved party.

The objective of damages, as stated in *Robinson,* can be achieved in case of property damage. Where the defective goods causes damage to other property, the party may be awarded the diminution in value of the property damaged. Here, it should be clear that the buyer may not be entitled to recover the diminution in value where his actual loss is the cost of cure, as discussed in chapter three. Chapter three of this thesis dealt with the quantification of damages for property damage caused by the defective goods supplied. Where the defective goods are placed or manufactured with other goods, they may cause damage to the whole goods.[31] This was the situation in the case of *Bostock & Co. Ltd v. Nicholson & Sons Ltd.*[32] In this case, the seller sold sulphuric acid, with a description

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[29] See S.M.Waddams, *The Law of Damages*, Toronto, 1983, p.155.

[30] (1848) 1 Exch 850, 855. Supra, p.1.

[31] In cases of property damage, as other cases of loss caused by a breach of contract, the restrictions imposed upon the recovery of damages should be satisfied. Here, the remoteness principle requires the property loss to be in the reasonable contemplation of the parties, at the time of making the contract, as not unlikely to result from the breach. For example, in *Vacwell Engineering Co., Ltd. v. B.D.H. Chemicals, Ltd.,* [1971] 1 QB 88 the buyer contracted with the seller for buying chemicals in order to be manufactured with other ingredients. The seller did not inform the buyer at the time of contracting that mixing the purchased chemicals with water would cause an explosion. The Court found that the nature of the parties' respective business made it a reasonable inference that the buyer would, and did, rely on the seller to warn him of the danger of mixing such chemicals with water. The Court found also that without an express warning there was a reasonably foreseeable risk that the chemical would come into contact with water in the ordinary course of any ordinary industrial use to which it might be put by a manufacturer. Upon that the buyer was awarded damages for the loss of property caused by an explosion resulting from the seller's breach of warranty of fitness for the purpose of the contract under Section 14(3) of the SGA. Similarly, in *Harbutt's "Plasticine" Ltd v. Wayne Tank and Pump Co. Ltd,* [1970] 1 All ER 225 where a defective heating system installed by the seller caused a fire and damaged the buyer's factory, the court awarded the buyer for the whole damage. See also *Henry Kendall & Sons v. William Lillico & Sons Ltd* [1969] 2 AC 31; *Parsons (Livestock) Ltd v Uttley Ingham & Co. Ltd* [1978] QB 791; *Wilson v. Rickett Cockerell & Co. Ltd* [1954] 1 QB 598. As for cases decided under the UCC, see *R.E.B., Inc. v Ralston Purina Co.*, 1975 U.S. App. LEXIS 12294; 18 UCC Rep. Serv. 122 (10th Cir. 1975); *Milbank Mutual Insurance Co. v. Proksch,* 1976 Minn. LEXIS 1507; 19 UCC Rep. Serv. 774 (1976); *Crandell v. Larkin & Jones Appliance Co.,* 1983 S.D. LEXIS 326; 36 UCC Rep. Serv. 78 (1983); *R. Clinton Construction Co. v. Bryant & Reaves, Inc.,* 1977 U.S. Dist. LEXIS 12222; 23 UCC Rep. Serv. 310 (1977).

[32] [1904] 1 KB 725. Similarly, see *Smith v. Green* [1875] 1 C.P.D. 92. In this case, the buyer bought a cow which appeared diseased. The cow was put with other cows which belonged to the buyer. As a result

that such an acid is free from arsenic, in order to be used for making brewing sugar. The sulphuric acid did not correspond with the description and the buyer alleged that the seller was in breach of an implied term under Section 13 of the SGA. The Court's award included the value of the other ingredients wasted by being mixed with the defective goods.[33] In such a case, it is worth mentioning that the use of the goods should be ordinary or communicated to the seller at the time of making the contract. Where the buyer intended to put the goods to an abnormal use, such damages cannot be recoverable unless such a use was communicated to the seller at the time of making the contract. This is likely to happen where the goods have multiple uses.[34]

Another significant point that may be considered in cases of property damage is the depreciation. The deterioration caused by the use of the goods for a period of time should be taken into account to reduce the buyer's damages.[35] In the UCC case of *Community Television Services v. Dresser Industries*,[36] a radio and television broadcasting tower collapsed by wind pressure. The Court held that the seller was liable for the breach of his express warranty as to the ability of the tower to resist wind pressure. The Court, in assessing damages for the loss, took into account the reasonable depreciation in the value of the goods resulting from the use that the buyer had enjoyed prior to the loss.[37] The court deducted from the buyer's gross loss, an amount equivalent to the buyer's use of the goods prior to the collapse of the tower.

The recovery of damages for personal injury in a contract action has been allowed in many cases under English and American law.[38] For example, in *Andrews v. Hopkinson*,[39] where the plaintiff was injured due to a technical defect in a car, the plaintiff was awarded damages for his personal injury.[40] Likewise, in the UCC case of

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all the cows were infected of the disease and died. The buyer was entitled to damages for the loss of all the cows.

[33] *Bostock & Co. Ltd v. Nicholson & Sons Ltd.,* [1904] 1 KB 725, 741-2.

[34] See *Randall v. Newson,* [1877] 2 QB 102.

[35] The depreciation is of no relevance for the assessment of loss of profit if the residual value of the goods at the end of their commercial life is considered. See chapter four, supra p.133, n.37.

[36] 1977 U.S. Dist. LEXIS 14804; 22 UCC Rep. Serv. 686 (1977).

[37] R.R. Anderson, supra n.24 at p.448.

[38] See Ellen A. Peters, 'Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two' (1963) 73 *Yale L.J.* 199, 272.

[39] [1957] 1 QB 229.

[40] See *Godley v. Perry*, [1960] 1 WLR 9 where the buyer had lost his eye by the breaking of a defective catapult, the Court awarded the buyer £2,500 for such a loss. See also *Geddling v. Marsh* [1920] 1 K.B. 668; *Morelli v. Fitch & Gibbons* [1928] 2 KB 636; *Wren v. Holt* [1903] 1 KB 610.

Klages v. General Ordnance Equipment Corp.,[41] the plaintiff was injured while he was trying to protect himself during a theft by using mace manufactured by the defendant. The mace did not function to incapacitate the robber as it was advertised by the defendant and as a result the plaintiff was shot. The Court held that the plaintiff was entitled to recover for his physical injuries resulting from breach of warranty of quality.[42]

At this place, it is worth noting that where a member of the buyer's family suffers personal injury, resulting from breach of warranty of quality, the buyer may bring a contract action for his financial loss resulting from the breach. In *Jackson v. Watson & Sons*,[43] the buyer had bought a salmon for human consumption. Due to the defective quality of the salmon, the buyer's wife died. In this case, the seller was in breach of warranty of quality. As a result the buyer was under a necessity of hiring someone to take care of his house and family. The buyer had successfully claimed damages for such a loss and for the expenses of the medicine and funeral of his wife.[44] For recovering damages in such a case, it should be in the reasonable contemplation of the parties, at the time of making the contract, that the goods will be used by the members of the buyer's family and it is not unlikely that they will be injured if the goods are defective.[45]

The buyer's claim in *Jackson* was only for pecuniary losses. However, personal injury may result in pecuniary and non-pecuniary losses. The buyer may recover damages for his medical care and loss of his earning capacity. Moreover, he may recover for some non-pecuniary losses such as physical inconvenience. The facts of *Jackson* case indicate that the buyer suffered non-pecuniary loss, i.e. his loss of the society of his wife. Loss of society of relatives is one of consequential losses which may result from a breach of contract. In the UCC case of *Phipps v. General Motors Corp.*,[46] the plaintiff was awarded damages for her loss of consortium. However, it should be mentioned here that

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[41] 1976 Pa. Super. LEXIS 1978; 19 UCC Rep. Serv. 22 (1976). See also *Diprospero v. R. Brown & Sons, Inc.* 1985 N.Y. App. Div. LEXIS 50927; 41 UCC Rep. Serv. 1651 (1985).
[42] See G.I. Wallach, supra n.28 at p.281.
[43] [1909] 2 KB 193.
[44] See also *Priest v. Last* [1903] 2 KB 148; *Frost v. Aylesbury Dairy Co. Ltd.* [1905] 1 KB 608; *Square v. Model Farm Dairies (Bournemouth) Ltd* [1939] 2 KB 365.
[45] A. G. Guest, *Benjamin's Sale of Goods,* London, 1997, para.17-068.
[46] 1976 Md. LEXIS 635; 20 UCC Rep. Serv. 312 (1976).

the recoverability of damages for non-pecuniary losses resulting from breach of contract is still unsettled in England and America, as discussed below.[47]

5.3 Damages for Physical Loss under the CISG

Article 74 of the CISG allows damages for all foreseeable losses caused by the seller's breach of warranty of quality. In fact, the buyer should be entitled to recover damages for all his losses in order to be placed in the same position he would have been in if the goods had been delivered as warranted. In other words, the objective of damages under the Convention is the same objective stated in *Robinson v. Harman*,[48] as mentioned in chapter one of this thesis. In view of that, one may expect that damages may be claimed for all types of loss resulting from the seller's breach of warranty of quality. However, the scope of the application of the CISG does not cover all kinds of physical loss.

Regarding personal injury and death, Article 5 of the Convention states that "This Convention does not apply to the liability of the seller for death or personal injury caused by the goods to any person." The impact of Article 5 is to exclude the applicability of the Convention to any personal injury or death which may occur to any person such as the buyer, sub-buyer, employees of the buyer or others. The recoverability of damages for personal injury and death is expressly left to be decided under domestic laws.[49] This is probably due to the various levels of development of the national laws regulating product liability and the impossibility of specialized international solutions to the issue of product liability.[50] This exclusion is more important to those systems, such as the French law, which does not apply the tort law rules to any dispute arising out of contractual relationship. In such systems the

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[47] Infra, p.178. In England, an action in tort for such a loss seems unavailable. Section 2 of the Administration of Justice Act 1982 states: "No person shall be liable in tort under the law of England... to a husband on the ground only of his having deprived him of the services or society of his wife..."

[48] (1848) 1 Exch 850, 855. Supra, p.1.

[49] See F. Enderlein and D. Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods: Convention on the Limitation Period in the International Sale of Goods*, London, 1992 at p.298; Peter Sarcevic and Paul Volken, *International Sale of Goods: Dubrovnik Lectures,* New York, 1992, p.35; Muna Ndulo, 'the Vienna Sales Convention 1980 and the Hague Uniform Laws on International Sale of Goods 1964: a Comparative Analysis' (1989) 38 *ICLQ* 1, 5.

[50] Henry Gabriel, *Practitioner's Guide to the Convention on Contracts for the International Sale of Goods (CISG) and the Uniform Commercial Code (UCC)*, London, 1994, p.21; B. Nicholas, 'The Vienna Convention on International Sales Law' 105 *LQR* 201, 208. See also Muhsin Shafiq, *The United Nations Convention on the International Sale of Goods*—in Arabic, Egypt [Cairo], at p.84; N.M. Galston and Hans Smit, *International Sales: The United Nations Convention on Contracts for the International Sale of Goods,* New York, 1984, p.1-38.

contractual remedies may offer more protection in cases of personal injury than those remedies provided by the CISG which are more concerned with commercial damage.[51]

As regards property damage, the CISG does not exclude the applicability of the Convention to property damage.[52] Proposals were addressed by some of the representatives in the Vienna Conference to exclude the liability for property damage from the scope of the application of the Convention. However, the proposals were not successful.[53] Damages for property loss can be recovered under Article 74 of the Convention. In this view, if the buyer suffers property loss as a result of breach of warranty of quality, he can claim damages under the Convention. The question whether or not he can claim damages in a tort action under the applicable domestic law has been discussed below.[54]

The last main issue here is whether Article 5 excludes the applicability of the Convention to the buyer's claim to recover an indemnity paid to a third party for personal injury caused by the seller's breach. This issue was raised in *Oberlandesgericht Düsseldorf,*[55] where a German buyer purchased from an American seller a machine which was sold to a Russian sub-purchaser. The machine proved defective and caused personal injury to the sub-purchaser who sought damages from the buyer. The buyer relied on the Convention to recover from the seller an indemnity payable to the sub-purchaser. In this case the Court made it clear that Article 5 does not exclude the applicability of the Convention to such a claim. The buyer's claim in this case was not

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[51] *United Nations Convention on Contracts for the International Sale of Goods (The Vienna Sales Convention) a Consultation Document,* Department of Trade and Industry, October 1997, p.13; *The United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980),* Explanatory Documentation prepared for Commonwealth Jurisdictions by Muna Ndulo in association with the Commonwealth Secretariat, October 1991, p.11.

[52] See J. Ramberg, 'Breach of Contract and Recoverable Losses', in R. Cranston (ed.), *Making Commercial Law: Essays in Honour of Roy Goode*, Oxford, 1997, 191, 192. See also M.J. Bonell and Fabio Liguori, *The U.N. Convention on the International Sale of Goods: A Critical Analysis of Current International Case Law*, [1997] *Revue de droit uniforme/ Uniform Law Review* 385-395; available at <http://cisgw3.law.pace.edu/cisg/biblio/libo1.html>, text accompanying note 40. See also *Handelsgericht Zürich,* Switzerland 26 April 1995 available at <http://cisgw3.law.pace.edu/cases/ 950426s1.html> where the Court did not allow the buyer damages due to his failure of notifying the seller of the defect within a resonable time after the discovery under Article 39(1) of the CISG; however, the court did not deny the applicability of the Convention to claims for property damage.

[53] See C.M. Bianca and M.J. Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention,* Milan, 1987 at p.50; F. Enderlein and D. Maskow, supra n.49 at p.298; Peter Sarcevic and Paul Volken, supra n.49 at p.47.

[54] Supra, p.175.

[55] Germany 2 July 1993 <http://cisgw3.law.pace.edu/cases/930702g1.html>.

for personal injury. The claim was for economic loss he suffered as a result of his liability to the sub-purchaser who suffered personal injury.

The words of Article 5 *"to any person"* imply that the Article is not only concerned with the buyer. In fact, as discussed in the following chapter, Article 4 of the CISG makes it clear that the Convention is only concerned with the "formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract." Therefore, the Convention does not apply to a claim brought by other than the buyer and the seller. In view of that, one may note that the privity doctrine applies under the Convention as discussed in the following chapter. Here, it should be clear that the privity requirement may not allow the sub-purchaser to sue the original seller in a contract action for the personal injury resulting from breach of warranty of quality. This would apply to any person, other than the direct buyer, who suffers personal injury as a result of the original seller's breach. In brief, there is no one, other than the buyer, expected to bring a successful suit in contract against the seller. In this sense, there is no need to exclude the applicability of the Convention to the third party's claim who suffered personal injury since such a claim is prohibited already by the privity doctrine.

So if there is no person other than the buyer who can sue the seller under the Convention for his breach of warranty, what do the words of Article 5 "*to any person*" mean? Does this mean that the Article excludes the applicability of the Convention to the buyer's claim to recover damages for his liability to a third party who has suffered personal injury resulting from the seller's breach? The issue is debatable. Some respected writers, such as Schlechtriem,[56] Bianca[57] and Honnold[58] suggest that the Court was mistaken in its decision in *Oberlandesggericht Düsseldorf.*[59] Referring to such writers, Article 5 excludes the applicability of the Convention to any claim based on personal injury incurred to the buyer or to a third party. However, Lookofsky and Bernstein,[60] see that Article 5 is concerned only with personal injury suffered by the buyer; the Convention

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[56] Peter Schlechtriem, Commentary on *Oberlandesggericht Düsseldorf* 2 July 1993, <http://cisgw3.law.pace.edu/cases/930702g1.html>.

[57] C.M. Bianca and M.J. Bonell, supra n.53 at p.49. See also Martin Karollus, 'Judicial Interpretation and Application of the CISG in Germany 1988-1994' (1995) *Cornell Review of the Convention on Contracts for the International Sale of Goods,* 51-94; available at <http://cisgw3.law.pace.edu/cisg/biblio/karollus.html>.

[58] John O. Honnold, *Uniform Law of International Sales under the 1980 United Nations Convention,* Boston, 2nd ed., 1991, pp.119-120.

[59] Germany 2 July 1993 <http://cisgw3.law.pace.edu/cases/930702g1.html>.

[60] H. Bernstein and J. Lookofsky, *Understanding the CISG in Europe,* London, 1997 at p.17, n.45.

should apply to the buyer's claim for indemnity paid to a third party for his personal injury resulting from the seller's breach.

Although I am inclined to support the latter opinion since the buyer's loss is economic, the words of Article 5 do not allow me to go to such an extent. The words of Article 5 "*to any person*" cannot be interpreted to other than excluding the applicability of the Convention to any claim based on a personal injury even though the injury is suffered by a third party. This is due to the fact that the third party is likely to be disallowed to sue the seller directly under the Convention due to the lack of the privity requirement. Therefore, the words of Article 5 should be interpreted to exclude the application of the Convention to the buyer's claim for his liability to a third party who suffered personal injury resulting from the seller's breach. Applying a different opinion may ignore the words of Article 5 of the Convention since it seems very difficult, in such a case, to find out the purpose of the words of Article 5. It is submitted that the CISG case of *Oberlandesggericht Düsseldorf*[61] was wrongly decided.

5.4 The "Choice of Action" in International Sale of Goods

Where physical loss results from breach of warranty of quality, the buyer may have the choice to sue in contract, tort or both under the English and American jurisdictions. The question here is whether such a choice is available to an international buyer under the CISG. In other words, where the CISG is applicable, can the buyer avoid its application by bringing an action in tort under the applicable domestic law?

The question may be of vital significance in two cases: the first case is where the buyer loses his right to sue under the CISG. This might happen where the buyer does not give a proper notice under Article 39 of the CISG.[62] If this becomes the case, the buyer may seek to bring an action in tort under the applicable domestic law. The second case is where the physical loss is too remote, the buyer might not be entitled to damages since

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[61] Germany 2 July 1993 <http://cisgw3.law.pace.edu/cases/930702g1.html>.

[62] Article 39 of the CISG states

(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.

(2) In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless this time-limit is inconsistent with a contractual period of guarantee.

Article 74 of the CISG[63] applies the remoteness restriction to the recovery for all kinds of damage. In such a case, where the buyer finds out that the applicable domestic law does not apply the remoteness principle to the recovery in tort, such as the case in the USA, he may choose to bring an action in tort under the domestic law rather than in contract under the CISG.

Such cases would not take place where the applicable domestic law does not allow the buyer to sue in tort for losses resulting from a breach of contract, such as the case in France. the French rule "*non-cumul*" excludes the application of tort law rules to any dispute arising out of a contractual relation between parties. In contrast, the aforementioned cases are of more significance where the applicable domestic law is too generous to the extent that it protects purely economic losses in tort; as a result the tort action for any loss resulting from a breach of contract would be allowed.[64]

A definite answer to the question, whether or not the buyer under the CISG can bring an action in tort under the domestic laws for losses resulting from the breach of contract, is still unattainable. There are extreme differences between the opinions of legal writers regarding this issue. Honnold suggests that the CISG displaces domestic laws with regard to the areas regulated by its rules.[65] His opinion is based mainly on the grounds that the applicability of domestic laws to areas governed by the Convention will affect the international aspect of the Convention.[66] He adds that if the buyer has the choice to sue under the CISG or the applicable domestic law, he will have more protection. Such protection will affect the balance between the parties that the CISG is devised to provide. Of course, the domestic laws can apply to a contract of international sale, governed by the Convention, where the provisions of the CISG excludes its application

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[63] Article 74 of the CISG states "Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract."

[64] Peter Schlechtriem, 'The Borderland of Tort and Contract—Opening a New Frontier?' (1988) 21 *Cornell Int'l L.J.* 467, 468.

[65] John O. Honnold, supra n.58. The same opinion can be found in F. Enderlein and D. Maskow, supra n.49 at p.298; Petar Sarcevic and Paul Volken, supra n.49 at p.47; C.M. Bianca and M.J. Bonell, supra n.53 p.50; J.M. Lookofsky, *Consequential Damages in Comparative Context: From Breach of Promise to Monetary Remedy in the American, Scandinavian and International Law of Contracts and Sales*, Denmark, 1989, p.285, n.166.

[66] John O. Honnold, supra n.58 at p.124.

only, such as sales to consumers (Article 2(a)), the validity of contract provisions[67] or usage (Article 4(a)) or cases of personal injury (Article 5).[68]

In contrast, another opinion suggests that one should distinguish between property and economic losses resulting from a breach of international sale contract under the CISG. As for the former, the aggrieved party should have the right to sue in tort if the applicable domestic law allows such a suit.[69] However, this should not be the case regarding the latter loss. Where the breach violates an economic interest of the contract, the CISG should displace domestic laws. In other words, according to this view, if the violation of economic interest gives rise to a tort action under the applicable domestic law, the CISG can displace such a law.[70] This opinion is based on the ground that the shape and extent of economic interests depend mostly on the agreement between the parties such as the time of delivery, payment and others.[71]

In the light of the above discussion, it seems that the opinion of Honnold is preferable. One should not ignore the fact that parties to an international sale contract come from different legal systems which might not be well-known to each others. Matters which give rise to a tort action in one country, might not in another. For example, the buyer may be allowed to bring a tort action for losses resulting from a breach of contract under English law. Such an action is normally disallowed under the French rule *"non-cumul"*. In order to avoid such differences among the several legal systems, the CISG was founded in order to offer the parties to an international sale contract one law which they can safely rely on with regard to their legal relationship. In this sense, the aggrieved party should not be permitted to circumvent the applicable rules of the CISG by bringing an action in tort under the applicable domestic law which may offer him better judgment.

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[67] The seller may not be able to exclude his liability for physical losses by implied or express terms included in the contract. Under the English and American law, such exclusion clauses are normally considered unconscionable. This is more likely in consumer contracts. Clearly, Section 2-719(3) of the UCC states that "... limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not." Section 6(2) of the Unfair Contract Terms Act 1977 provides that "As against a person dealing as consumer, liability for breach of the obligations arising from— (a) [section 13, 14 or 15 of the [1979] Act] (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose)... cannot be excluded or restricted by reference to any contract term."[67]

[68] John O. Honnold, supra n.58 at p.124.

[69] See H. Bernstein and J. Lookofsky, supra n.60 at p.57; Peter Schlechtriem, supra n.64 at p.473.

[70] See H. Bernstein and J. Lookofsky, ibid at p.57; Peter Schlechtriem, supra n.64 at p.473.

[71] Peter Schlechtriem, ibid at p.473.

5.5 The Recoverability of Damages for Non-Pecuniary Losses

In general, damages for losses resulting from breach of warranty of quality should be recovered under the normal restrictions. Ignoring losses resulting from the breach may be in direct contradiction with the principle of *Robinson v. Harman*,[72] as discussed below. However, English law seems to be reluctant to allow damages for certain non-pecuniary losses resulting from a breach of contract. It confines the recovery of damages for such loss to certain cases mentioned below. Non-pecuniary losses may include physical inconvenience, disappointment, distress, frustration, anxiety, displeasure, vexation and tension. Damages for physical inconvenience can be recoverable under the normal restrictions. It can be noted that this damage is normally accompanied with physical damage. Where physical inconvenience results from a breach of contract without being accompanied with physical injury, damages may still be recoverable under the normal restrictions. This has been decided in the old case of *Hobbs v. London and South Western Railway Co.*,[73] where the plaintiff suffered physical inconvenience as a result of the defendant's breach. In this case, the Court awarded damages for physical inconvenience.[74] Similarly, in the recent case of *Watts and Another v. Morrow*,[75] the Court of Appeal awarded damages for physical inconvenience suffered as a result of the breach of contract.[76]

In comparing English law with American law, one may state that English law deals better with the recoverability of damages for physical inconvenience. Although Section 2-714 of the UCC allows damages for all losses resulting from breach of warranty, it seems that the courts do not have a coherent attitude towards the availability of such damages. In *McGrady v. Chrysler Motors Corp.*,[77] the Court of Appeal of Illinois followed the rule, stated by the Supreme Court of Mississippi in *William A. Allen v. Edwards*,[78] that "mere inconvenience, without more, is not a proper element of

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[72] (1848) 1 Exch 850, 855. Supra, p.1.

[73] (1875) 10 QB 111. In this case, a family were transported by a railway company to the wrong station. The Court awarded them damages for physical inconvenience resulting from walking several miles home on a wet night.

[74] Ibid at p.115.

[75] [1991] 4 All ER 937.

[76] See *Burton v. Pinkerton,* (1867) 2 Exch. 340 where the Court awarded damages for the physical inconvenience caused by the defendant's breach of his employment contract.

[77] 1977 Ill. App. LEXIS 2230; 21 UCC Rep. Serv. 532 (1977).

[78] 217 So. 2d 284 (1969).

damages."[79] Similarly, in *Sellinger v. Freeway Mobile Home Sales, Inc.*,[80] where the plaintiff suffered physical inconvenience as a result of a defective mobile home, the Court of Appeal upheld the trial court's refusal to award damages for such a harm.

However, in *Mobile Home Sales Management, Inc. v. Brown,*[81] the Court of Appeal of Arizona did award damages for physical inconvenience resulting from the lack of air-conditioning and heating caused by a defective mobile home. The Court did not require the buyer to show physical injury in order to recover damages for physical inconvenience; in other words, the Court awarded such damages without requiring such inconvenience to be accompanied with physical injury. The two mentioned cases, *Sellinger* and *Brown*, seem to have similar facts but they were decided differently. Such a difference may be due to the degree of the severity of physical inconvenience in each case.[82]

Nonetheless, It is submitted that damages should be awarded for physical inconvenience under the normal restrictions imposed on the recovery of damages. This seems to be the attitude of English law. It seems that the availability of damages for physical inconvenience in the USA is not predictable. The courts award such damages depending on the circumstances of each case taking into account mainly the severity of such an inconvenience. It seems that physical inconvenience is analogous to physical injury. The award of damages for the latter is beyond question; therefore, one might find it difficult to justify the anxiety of the American courts to award damages for physical inconvenience.

As for other non-pecuniary losses, such as distress, frustration, anxiety, displeasure, vexation and tension, it is still unclear whether damages can be recoverable under the normal restrictions. There seems to be an inconsistency in the law reports regarding the recoverability of damages for non-pecuniary losses in England and America. It is intended to examine the recoverability of damages for such non-pecuniary losses in the following section. For the sake of simplicity, the term "mental distress" will be used to represent disappointment, frustration, anxiety, displeasure, vexation and tension.

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[79] *William A. Allen v. Edwards,* 217 So. 2d 284 at p.287 (1969).
[80] 1973 Ariz. App. LEXIS 690; 12 UCC Rep. Serv. 879 (1973).
[81] 1977 Ariz. App. LEXIS 546; 21 UCC Rep. Serv. 1040 (1977).
[82] R.R. Anderson, supra n.24 at p.467.

As regards the CISG, Comment 3 to Article 74 of the Convention provides that "the basic philosophy of the action for damages is to place the injured party in the same economic position he would have been in if the contract had been performed." In this sense, damages under the Convention are aimed to deal with the financial loss of the aggrieved party only. This observation can be supported by Article 5 of the Convention which makes the recoverability of damages for personal injury beyond the scope of the Convention. Therefore, one can reach the conclusion that the recoverability of damages for non-pecuniary losses is left to be decided under the applicable domestic law.[83]

5.5.1 Damages for Mental Distress[84]

As discussed below, the objective of damages, as stated in *Robinson v. Harman,*[85] may not be achieved if the court disallows damages for mental distress. In other words, damages for mental distress should be recovered under the normal restrictions. Here, one may need to distinguish between consumer and commercial cases. In commercial cases, breach of warranty of quality is unlikely to result in mental distress. The buyer, in such cases, is likely to be relieved by the award of damages which puts him in the same financial position he would have been in if the goods had been free of defects.[86] The commercial buyer is not expected to have emotional attachment to the goods. Most likely, such a buyer will be concerned with the profit which can be gained by using the goods in question. In *Hutchinson v. Harris,*[87] where the defendant was in breach of a

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[83] Under the French law, damages can in principle be recovered for mental distress resulting from a breach of contract. See Nelson Enonchong, 'Breach of Contract and Damages for Mental Distress' (1996) 16 *O.J.L.S.* 617, 636. The writer refers to Mazeaud, Mazeaud and Chabas, Leçons de droit civil, obligations, 8th ed., 1991, paras 422-3. See also M.G. Bridge, 'Contractual Damages for Intangible Loss: A Comparative Analysis' (1984) 62 *Can. Bar Rev.* 323, 352.

[84] Mental distress should be distinguished from mental illness. the latter is a kind of physical injury for which damages can be awarded under the normal restrictions. Nervous shock, suffered by the aggrieved party, should be distinguished from other harms such as anxiety or indignity. Damages for mental illness may be awarded if such an illness was in the reasonable contemplation of the parties, at the time of making the contract, as not unlikely to result from the breach. *Hadley v Baxendale* [1854] 9 Exch 341; *Victoria Laundry v Newman Industries Coulson & Co Ltd* [1949] 2 KB 528; *Koufos v Czarnikow Ltd (The Heron II)* [1969] 1 AC 350; *Parsons (Livestock) Ltd v Uttley Ingham & Co. Ltd* [1978] QB 791. The remoteness principle applies to the recovery of damages for mental distress as follows: the principle can be satisfied where at the time of making the contract the parties reasonably contemplated, as a serious possibility, that mental distress would result from the potential breach. However, Lord Denning M.R.'s approach, in the last case, is preferable here since mental distress is analogous to physical damage. On this point see A.S. Burrows, 'Mental Distress Damages in Contract- a Decade of Change' [1984] *LMCLQ* 119, 132.

[85] (1848) 1 Exch 850, 855. Supra, p.1.

[86] Iwan Davies, *Sale and Supply of Goods,* 2nd ed., 1996, p.333.

[87] [1978] 10 Build. L.R. 19.

contract of converting a house into flats, the Court of Appeal was reluctant to award damages for mental distress since the plaintiff was converting the house to let for profit. Furthermore, in *Alexander v Alpe Jack, Rolls-Royce Motor Cars Ltd.,*[88] Beldam LJ pointed out that "[t]he general rule is that damages for distress, inconvenience or loss of enjoyment are not recoverable for breach of an ordinary commercial contract...".[89] In *Hays and another v. James & Charles Dodd (a firm)*[90] Staughton LJ said that

> "I am not convinced that it is enough to ask whether mental distress was reasonably foreseeable as a consequence, or even whether it should reasonably have been contemplated as not unlikely to result from a breach of contract. It seems to me that damages for mental distress in contract are *as a matter of policy, limited to certain losses of case.... But it should not in my judgment, include any case where the object of the contract was not comfort or pleasure, or the relief of discomfort, but simply carrying on a commercial activity with a view to profit.*"[91] [Emphasis added].

However, the position may be different in consumer cases. The consumer buyer[92] may suffer mental distress resulting from breach of warranty of quality. The question here is whether damages can be awarded for such a distress. In *Bernstein v. Pamson Motors Ltd.,*[93] where a consumer buyer purchased a car, which appeared defective, Rougier J awarded the buyer damages for "a total spoilt day comprising nothing but vexation". However, the Court in this case did not discuss the recoverability of such damages nor did it cite any authority for such an award. Therefore, the case does not seem helpful in deciding whether such damages are generally available for defective goods. Moreover, in *Jackson v. Chrysler Acceptances Ltd.,*[94] the Court of Appeal allowed the buyer damages for spoiled holiday caused by the defective car purchased. This case, as discussed below,[95] falls under one of the exceptions where damages for non-pecuniary losses can be recoverable.

Here, one needs to extend the research to deal with other cases of contract law in order to find out whether damages for mental distress are generally recoverable. Under the American law, as will be seen, there seems to be inconsistency in the recoverability of

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[88] *The Times,* 1995, 4 May. In this case the buyer claimed damages for the distress and inconvenience he suffered as a result of the breach of service contract of repairing a Rolls-Royce car. The Court of Appeal held that damages for distress and inconvenience are not recoverable.
[89] *Alexander v Alpe Jack, Rolls-Royce Motor Cars Ltd., The Times,* 1995, 4 May.
[90] [1990] 2 All ER 815.
[91] Ibid at p.824.
[92] This argument may not apply where the consumer is not a natural person.
[93] [1987] 2 All ER 220.
[94] [1978] RTR 474.

damages for mental distress. The recoverability of such damages varies among the several States. Also, one may notice that there is no coherent attitude towards such a recoverability in every single State.[96]

5.5.1.1 The Rule of *Addis v. Gramophone*: Reality or Illusion?

In *Addis v. Gramophone Co. Ltd.*[97] the plaintiff had been employed by the defendant as a manager. Under his contract of employment he was entitled to six months' notice of dismissal. He was given this notice by the defendant but he left his work before the end of the notice period since the defendant had made it impossible for him to do his work. The plaintiff was awarded damages for his financial losses resulting from depriving him of a proper notice period, i.e. resulting from breach of the employment contract. However, the House of Lords did not award damages for the injury to his feeling and reputation resulting from the dismissal.

This vagueness of the decision by the House of Lords in this case was a source of confusion in English law, regarding the recoverability of damages for non-pecuniary loss in contract, for approximately ninety years. It was commonly thought that *Addis* stated the rule of the general non-recoverability for non-pecuniary losses. It is true that in *Cox v. Phillips Industries Ltd.*,[98] the Court provided expressly that damages for mental distress are recoverable if it was in the reasonable contemplation of the parties, at the time of contracting, as a serious possibility that the breach would expose the plaintiff to the vexation, frustration and distress.[99] However, the decision in *Cox* was overruled in *Bliss v. South East Thames Regional Health Authority*[100] where mental distress was caused by a breach of employment contract. In this case, Dillon LJ pointed

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[95] Infra, p.187.
[96] Infra, p.189.
[97] [1909] AC 488. See also the previous cases of *Hamlin v. G.N. Ry.* (1856) 1 H. & N. 408 where the Court of Exchequer ruled that a delayed passenger was not entitled to recover damages for the disappointment resulting from the breach of contract. In *Hobbs v. London and South Western Railway,* [1875] 10 QB 111, where the plaintiff and his family were delivered late at night to the wrong station, Mellor J said at, p.122, that "... for the mere inconvenience, such as annoyance and loss of temper, or vexation, or for being disappointed in a particular thing which you have set your mind upon, without real physical inconvenience resulting, you cannot recover damages."
[98] [1976] 1 WLR 638. See B.S. Jackson, 'Injured Feelings Resulting from Breach of Contract' (1977) 26 *ICLQ* 502, 505.
[99] *Cox v. Phillips Industries Ltd.* [1976] 1 WLR 638, 644. In this case, Lawson J, at p.644, said that "I can see no reason in principle why, if a situation arises which within the contemplation of the parties would have given rise to vexation, distress and general disappointment and frustration, the person who is injured by a contractual breach, should not be compensated in damages for that breach."
[100] [1987] *Industrial Cases Reports* 700.

out that the decision in *Cox* was wrong since it was inconsistent with the general rule stated in *Addis v. Gramophone Co. Ltd.*[101] Dillon LJ held that damages for mental distress are still generally not available in contract; such damages can only be awarded under some exceptions.[102]

In the recent case of *Malik v. BCCI,*[103] Lord Steyn made it clear that there is a misunderstanding of the decision in *Addis.* His Lordship stated that the plaintiffs in *Addis* were not allowed damages for their non-pecuniary loss on the ground of lack of causation. His Lordship said that "*Addis's* case simply decided that the loss of reputation in that particular case could not be compensated because it was not caused by a breach of contract."[104] Now, one may suggest that the vagueness of the decision of *Addis*, has been removed by the thoughtful speech of Lord Steyn. The question here is whether the case of *Malik* was intended to allow, in principle, the recovery for mental distress resulting from breach of contract.

In *Malik,* the plaintiffs were employees in a bank which collapsed as a result of massive fraud perpetrated by those controlling the bank. The plaintiffs were not aware of and had no part in the fraud. The plaintiffs found it difficult to find a job in the banking field due to their association with the bank. The plaintiffs were entitled to damages for the financial loss resulting from the breach of the trust and confidence term of their employment contract.[105] In this case, the House of Lords held that the plaintiffs were

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[101] [1909] AC 488.

[102] In *Bliss v. South East Thames Regional Health Authority* [1987] *Industrial Cases Reports* 700 Dillon LJ, at pp. 717-8, said: "where damages fall to be assessed for breach of contract rather than in tort it is not permissible to award general damages for frustration, mental distress, injured feelings or annoyance occasioned by the breach... There are exceptions now recognized where the contract which has been broken was itself a contract to provide peace of mind or freedom from distress...".

[103] [1998] AC 20.

[104] Ibid at p.51. Lord Steyn cited Nelson Enonchong, 'Contract Damages for Injury to Reputation' (1996) 59 *MLR* 592. However, one cannot ignore the fact that Lord Atkinson, in *Addis* at p. 494, considered the award of damages for injured feelings as a kind of punishment which does not meet the compensatory nature of damages in contract law. See M.G. Bridge, 'Contractual Damages for Intangible Loss: A Comparative Analysis' (1984) 62 *Can. Bar Rev.* 323, 343.

[105] The Court of Appeal in *Marbe v George Edwards (Daly's Theatre) Ltd,* [1928] 1 KB 269 and *Withers v General Theatre Corp Ltd* [1933] 2 KB 536 distinguished between two kinds of social reputation, i.e., an existing reputation or a reputation which would have been acquired if the contract had not been breached. In the latter case, the Court of Appeal awarded damages for the loss of reputation which would have been acquired if the contract had not been breached and refused to award for the damage of an existing reputation. The Court of Appeal, in this case, did not follow the decision in *Marbe* where the award was for the loss of both kinds of reputation. In the recent case of *Malik v BCCI,* [1998] AC 20, 41 the House of Lords rejected expressly the idea that damages can be only awarded for the loss of reputation which would have been acquired if the contract had not been breached and not for the damage of an existing reputation. Lord Nicholls, in this case, indicated that the decision in *Marbe* was decided rightly.

entitled to damages for the reasonably foreseeable financial loss suffered by the plaintiffs.[106]

Obviously, the House of Lords, in *Malik*, made it clear that damages, in appropriate cases, could in principle be awarded for loss of reputation resulting from a breach of contract. In fact, these appropriate cases are mostly where the loss of reputation is accompanied with financial loss.[107] Indeed, there is no authority provided by the House of Lords in *Malik* for allowing damages for loss of reputation where no financial loss results. This discourages me from suggesting that the issue of recoverability of damages for mental distress has been brought to an end by the decision in *Malik.* In this case, Lord Nicholls pointed out that "[f]or present purposes I am not concerned with the exclusion of damages for injured feeling. The present case is concerned only with financial loss."[108] Therefore, I need to carry on to find out whether damages can be recovered for mental distress resulting from breach of warranty of quality. Hopefully, examining cases, where the recoverability of damages for mental distress is not debatable will help.

5.5.1.2 Cases where the Recoverability of Damages for Emotional Distress is not Debatable

Damages for mental distress in contract action seems to be well settled in cases where the object of the contract is to provide mainly relaxation or pleasurable amenity.[109] In fact, in such cases, the court achieved the objective of damages stated in *Robinson v. Harman.*[110] For example, in *Jarvis v. Swan Tours Ltd.,*[111] where distress was suffered as

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[106] The recovery of damages for loss of or injury to reputation is normally claimed in a tort action under the law of defamation. However, the claim for loss of or injury to reputation may succeed in a contract action if a financial loss resulting from an injury to reputation. In *Foaminol Laboratories Ltd. v British Artid Plastics Ltd.,* [1941] 2 All ER 393 Hallett J, at pp.399-400 pointed out that"... a claim for mere loss of reputation is the proper subject of an action for defamation, and cannot ordinarily be sustained by means of any other form of action... However... if pecuniary loss can be established, the mere fact that the pecuniary loss is brought about by the loss of reputation caused by a breach of contract is not sufficient to preclude the plaintiffs from recovering in respect of that pecuniary loss."

[107] *Marbe v George Edwards (Daly's Theatre) Ltd*[1928] 1 KB 269; *Dunk v George Waller & Son Ltd,* [1970] 2 QB 163; *Aerial Advertising Co. v Batchelors Peas Ltd (Manchester)* [1938] 2 All ER 788; *Anglo-Continental Holidays Ltd v Typaldos Lines (London) Ltd,* [1967] 2 Lloyd's Rep 61. See J. Beatson, *Anson's Law of Contract,* Oxford, 27th ed., 1998, p.563; Nelson Enonchong, 'Contract Damages for Injury to Reputation' (1996) 59 *MLR* 592, 595.

[108] *Malik v. BCCI* [1998] AC 20,38.

[109] See Francis Dawson, 'General Damages in Contract for Non-Pecuniary Loss' (1983) 10 *N.Z.U. L. Rev.* 232.

[110] (1848) 1 Exch 850, 855. Supra, p.1.

[111] [1973] 1 QB 233.

a result of breach of contract for a holiday, the Court of Appeal held that damages for mental distress can be recovered in proper cases such as where the contract is supposed to provide entertainment and enjoyment.[112] The award of damages for mental distress, in such a case, aims to compensate the aggrieved party for his disappointment at the deprivation of a potential mental benefit.[113] Certainly, the aggrieved party should be awarded for his loss of the object of the contract; if a party does not fulfil his obligation under a contract, he may be liable in damages for the other party.

Damages can also be awarded in cases of contract intended to provide freedom from worry and anxiety. For example, in *Heywood v. Wellers*,[114] the plaintiff employed the solicitors (defendants) to take proceeding at law to protect her from molestation by a third party. The solicitors were under a duty by contract to use reasonable care. However, the solicitors failed in their duty and as a result the plaintiff suffered more upset and distress. The Court awarded the plaintiff damages for mental distress on the ground that it should have been in the contemplation of the parties, at the time of contracting, that such a failure will lead to more mental distress for the plaintiff.[115]

Furthermore, damages for mental distress can be awarded if such a distress is related to physical inconvenience.[116] For example in *McCall v. Abelesz*,[117] where a landlord harassed a tenant, Lord Denning M.R. pointed out that damages can be awarded for distress consequent upon physical inconvenience.[118] In this sense, damages for mental distress should normally be recoverable where they are related to physical inconvenience.[119] In *Watts and Another v. Morrow,*[120] Bingham LJ said

> "[w]here the very object of a contract is to provide pleasure, relaxation, peace of mind or freedom from molestation, damages will be awarded if the fruit of the contract is not provided or if the contrary result is procured instead. If the law

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[112] Ibid at p.238. Lord Denning said that "[i]n a proper case damages for mental distress can be recovered in contract... One such case is a contract for a holiday or any other contract to provide entertainment and enjoyment".

[113] A.S. Burrows, supra n.84 at p.124.

[114] [1976] 1 QB 446.

[115] Ibid at p.459.

[116] See the judgment of Kerr LJ in *Perry v. Sidney Phillips* [1982] 1 WLR 1297.

[117] [1976] Q.B. 585.

[118] *McCall v. Abelesz,* [1976] QB 585, 594.

[119] *Summers v. Salford Corporation,* [1943] AC 238; *Godley v. Perry,* [1960] 1 WLR 9. See also Elizabeth Macdonald, 'Contractual Damages for Mental Distress' (1994) 7 *JCL* 134, n.4. Damages for mental distress, which is related to physical injury, were awarded under the head "pain and suffering". See Harvey McGregor, *McGregor on Damages*, London, 16th ed., 1997, p.54; A.S. Burrows, supra n.84 at p.127.

[120] [1991] 4 All ER 937.

> did not cater for this exceptional category of case it would be defective.... In cases not falling within this exceptional category, damages are... recoverable for physical inconvenience and discomfort caused by the breach and mental suffering directly related to that inconvenience and discomfort."[121]

The above discussion shows that damages for mental distress may be allowed in certain cases. However, it should be noted that the decisions of the courts regarding the recoverability of such damages show no coherent attitude. For example, in *Perry v Sidney Phillips & Son (a firm)*[122] the Court of Appeal awarded damages for distress, worry, inconvenience and trouble which the plaintiff had suffered while living in the house he bought, owing to the defects which his surveyor had overlooked. In this case Lord Denning MR based his decision on the ground that such a distress was not too remote.[123] It was held that these losses were reasonably in the contemplation of the parties at the time of making the contract as not unlikely to result from this breach. However, in *Watts and Another v. Morrow*,[124] such damages were not awarded. In this case, the plaintiffs asked the defendant to provide a full structural survey of a house. The defendant's report revealed no more than defects which could be dealt with as a part of ordinary ongoing maintenance and repair.[125] In reliance upon this report the plaintiff bought the house. In fact there were major defects in the house. At first instance, it was found that the defendant had acted negligently since the report had not revealed such defects. The trial judge awarded damages for mental distress on the ground that the plaintiff asked for a structural survey in order to reassure that he will have peace of mind and freedom from distress after he buys the house. However, the Court of Appeal awarded the plaintiff for his financial loss[126] but refused to award for the mental distress suffered by the plaintiff as a result of the defendant's negligence. The Court applied the general non-availability rule and found that this case cannot be classified under any of the exceptions to the general non-availability rule. The ordinary surveyor's contract does not undertake to provide peace of mind and freedom from distress; the distress was not

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[121] *Watts and Another v. Morrow,* ibid at p.960.
[122] [1982] 1 WLR 1297.
[123] Ibid at p.1302. In this case, Kerr LJ based his award on the ground that the mental distress followed from the physical inconvenience caused by the breach. Kerr LJ applied the rule of the general non-availability of damages for mental distress.
[124] [1991] 4 All ER 937.
[125] Ibid at p.941.
[126] In this case, the Court of Appeal refused to award the cost of cure which was awarded at first instance. Instead it awarded the diminution in value which was less than the cost of cure.

related to physical inconvenience.[127] Instead, the Court of Appeal awarded damages for physical inconvenience, which were less than the award for mental distress.

5.5.1.3 Are Damages for Mental Distress Recoverable in a Breach of Warranty Action?

In light of the above discussion, can the buyer recover damages for mental distress resulting from breach for warranty of quality? As discussed below, disallowing damages for mental distress may ignore the principle of *Robinson v. Harman*.[128] In any case, where the distress is related to physical injury or inconvenience caused by breach of warranty of quality, the buyer may be allowed damages for such distress. Where the breach does not result in a physical inconvenience, the buyer may have a chance to recover for loss of pleasurable amenity where the main object of the contract is to provide pleasurable amenity. This is unlikely to be the case of commercial contract. However, in consumer contracts, the buyer may purchase a good, such as a mobile house (caravan), for the sake of relaxation and pleasurable amenity. In such a case, the buyer may be entitled to recover damages for loss of such pleasurable amenity caused by breach of contract. This was the case in *Jackson v. Chrysler Acceptances Ltd.*[129] where the buyer purchased a car which appeared defective and spoiled his holiday. The buyer made it clear, at the time of making the contract, that he will use the car in his holiday in France. The Court of Appeal allowed the buyer "the difference between [the] holiday as it could reasonably have been expected to be with a car in proper condition and with [the defective] car as it was...."[130]

In the recent case of *Ruxley Electronics and Construction Ltd. v. Forsyth,*[131] the House of Lords approved the award of damages for loss of pleasurable amenity resulting from breach of contract. The award of damages for loss of pleasurable amenity may be available in cases where such amenity is the predominant object of the contract.[132] Thereupon, in a contract of purchase of a house, relaxation might be one of the purposes of the contract but not the main one. In such a case, if the potential relaxation has not

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[127] *Watts and Another v. Morrow,* [1991] 4 All ER 937, pp.954-8.
[128] (1848) 1 Exch 850, 855. Supra, p.1.
[129] [1978] RTR 474.
[130] Ibid at p.481. The Court of Appeal held that the buyer's damages for spoiled holiday should be greater than the £75 awarded at first instance.
[131] [1996] 1 AC 344.
[132] Elizabeth Macdonald, supra n.119 at p.145.

been obtained, by reason of the seller's breach, the purchaser may not recover damages for such a loss unless it is related to physical inconvenience.[133]

The award of damages for loss of pleasurable amenity is intended to compensate the buyer for the loss of the object of the contract caused by the breach of seller. Therefore, it is not an award for mental distress resulting from the breach of contract. Nevertheless, in *Ruxley,* Lord Lloyd stated that *Addis* "established the general rule that in claims for breach of contract, the plaintiff cannot recover damages for his injured feelings."[134] However, his Lordship disallowed the application of such a rule in cases where the object of the contract is to afford a pleasure. However, such a view that *Addis* established the rule of non-availability of damages for non-pecuniary loss was soon overruled by Lord Steyn in *Malik v. BCCI*[135] as previously explained.[136]

So, can the buyer recover damages for mental distress resulting from breach of contract where the breach does not cause any physical injury or inconvenience provided that the contract is not intended to provide pleasurable amenity? For example, suppose that the buyer has contracted with a restaurant to provide food for the guests at his wedding ceremony. Suppose further that the food appeared to be defective and the guests suffered physical injury due to the defective quality of the food. In such a case, the guests might be able to sue the restaurant in a tort action. However, our concern here is whether the buyer can sue the restaurant in a contract action for mental distress.[137] In fact, in the light of the inconsistency in the law reports, one may not be able to provide a clear-cut answer to this question. It is difficult to assume that the English Court will allow such damages under the normal restrictions imposed upon the recoverability of damages. Here, it is convenient to examine the American Authority before I conclude whether or not such damages should be generally available under the normal restrictions.

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[133] *Jarvis v. Swans Tours Ltd.* [1973] QB 233.
[134] *Ruxley Electronics and Construction Ltd. v. Forsyth,* [1996] 1 AC 344, 374.
[135] [1998] AC 20.
[136] Supra, p.182.
[137] If the contract in such a case is intended to provide pleasure, the buyer may be entitled to recover damages for mental distress suffered by him and his guests. See *Jackson v. Horizon Holidays Ltd.* [1975] 1 WLR 1468.

5.5.1.4 The Position in American Law

Although Section 2-714 of the UCC allows damages for all losses resulting from breach of warranty, all American jurisdictions adopt the general non-recoverability rule. However, it seems well settled that such damages are recoverable, in principle, in cases of loss of enjoyment or entertainment.[138] Furthermore, damages for mental distress may be awarded in cases where such a distress follows from bodily injury. For example, in *Wellcraft Marine, Inc. v. Zarzour,*[139] it was held that damages for mental distress can be awarded exceptionally where the breach is tortious or is attended with personal injury, or where the contractual duty is coupled with matters of mental concern or solicitude.

A comparison between English and American law shows that the latter has gone a step forward in allowing damages for mental distress. It is clear that damages for mental distress are awarded under American law in the cases where the recoverability of such damages is not debatable under English law. In addition, damages for mental distress can be recovered where such a distress is too severe. The Restatement (Second) of Contracts allows damages for mental distress in two situations,[140] i.e. where mental distress follows from physical harm or where the breach is of such a kind that serious emotional disturbance was a particularly likely result. For example, in *Joyce Ruth Wise v. General Motors Corp.*,[141] it was held that damages for mental distress are generally unavailable in a contract action except in cases where there is bodily injury or where serious mental distress was likely to result. Here, it should be noted that the Restatement (Second) of Contracts does not impose the application of the remoteness principle on the recovery of damages for mental distress.[142] Therefore, in certain cases, damages for mental distress, resulting from a breach of contract, can be awarded regardless of whether or not such a distress is too remote.[143]

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[138] For example, in *Martel v. Duffy-Mott Corp.,* 1968 Mich. App. LEXIS 787; 6 UCC Rep. Serv. 294 (1968) where the buyer purchased an applesause which appeared inedible, he was awarded damages for loss of enjoyment of eating the applesause. See also *McManus v. Galaxy Carpet Mills, Inc.* 1983 La. App. LEXIS 8607; 433 So. 2d 854 (1983) where the buyer was allowed damages for mental distress, resulting from the defective quality of the goods purchased. The court found that the intellectual enjoyment, which was the main object of the contract, was frustrated by the breach.

[139] 1990 Ala. LEXIS 1156; 15 UCC Rep. Serv. 2d 109 (1990).

[140] Restatement (Second) of Contracts [1981] §353 provides "Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result."

[141] 1984 U.S. Dist. LEXIS 15275; 39 UCC Rep. Serv. 900 (1984).

[142] The UCC does not impose the application of the remoteness principle to the recovery of damages for physical loss.

[143] In a non-UCC case, *B & M Homes, Inc. v. Hogan,* 1979 Ala. LEXIS 3570; 376 So. 2d 667 (1979), the Supreme Court of Albama awarded damages for mental distress resulting from breach of contract of

There seems to be inconsistencies among the American jurisdictions regarding the availability of damages for mental distress. The exceptions provided by the Restatement (Second) of Contracts can widely or strictly be construed. For example, in *Volkswagen of Am., Inc. v. Dillard,*[144] a buyer of a new mobile home was awarded damages for mental distress resulting from the seller's breach of an express warranty. In this case the buyer had suffered numerous problems with the vehicle over a period of almost two years. Probably one can justify such an award under the second exception stated by the Restatement (Second) of Contracts.[145] However, in *Kwan v. Mercedes-Benz of North America, Inc.,*[146] a buyer of a defective automobile was not awarded damages for mental distress under Section 2-715 of the UCC on the grounds that this section does not include recompense for mental suffering independent from physical injury.[147]

Occasionally, damages for mental distress were awarded exceptionally on the grounds of public policy. For example, in *Bogner v. General Motors Corp.*,[148] the buyer was awarded damages for her emotional harm resulting from a delay in her vacation caused by the failure of the manufacturer to supply a reasonably prompt warranty service. In this case the Court indicated that such damages are normally not awarded, in cases of breach of contract, without an accompanying tort. However, the Court did award damages for emotional harm on the ground that public policy favours the award of such damages in that case. Furthermore, in other cases, mental distress was dealt with as a

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purchase of a house which appeared defective. In this case, the Court found that the mental distress was reasonably foreseeable by the parties at the time of making the contract. Upon that, the court awarded damages for the mental distress. This case was discussed in G. I. Wallach, supra n.28 at p.283; R.R. Anderson, supra n.24 at p.465. Similarly, see *Rogowicz v. Taylor & Gray Inc.,* 1973 Texas App. LEXIS 2658; 498 S.W.2d 352 (1973) discussed in M.J. Staff 'the Consequences of Consequential Damages: a Survey of Buyer's Damages under Chapter 2' (1982) 45 *Tex. B. J.* 1211, 1214.

[144] 1991 Ala. LEXIS 214; 14 UCC Rep. Serv. 2d 475 (1991).

[145] The second exception of the Restatement (Second) of Contracts is concerned with the severity of damage. Damages are unlikely to be recovered for mere embarrassment. See *Hobbley v. Sears, Roebuck & Co.* 1984 Fla. App. LEXIS 13366; 450 So. 2d 332 (1984) where the buyer contracted with the seller to supply and install furnace in home, the buyer was entitled to recover damages for physical discomfort caused by absence of furnace during the winter but not for embarrassment incurred as result of heating house with space heaters when guests visited.

[146] 1994 Cal. App. LEXIS 218; 23 UCC Rep. Serv. 2d 99 (1994). See also *Burnell v. Morning Star Homes, Inc.* 1985 N.Y. App. Div. LEXIS 53337; 494 N.Y.S. 2d 237 (1985).

[147] A.M. Squillante and J.R. Fonseca, *Williston on Sales,* Vol.3, 4th ed., 1996, pp.978, 1021. See also *Stratton-Baldwin Co. v. Brown,* 1977 La. App. LEXIS 4680; 343 So 2d 292 (1977) where the buyer was not entitled to recover damages for mental distress resulting from breach of warranty of quality of carpeting and flooring material.

[148] 1982 N.Y. Misc. LEXIS 4090; 35 UCC Rep. Serv. 466 (1982). See also *Deitsch v. Music Co.*, 1983 Ohio Misc. LEXIS 379; 6 Ohio Misc. 2d 6 (1983).

kind of personal injury. For example, in *Hirst v. Elgin Mental Casket Co.,*[149] the United States District Court of Montana allowed damages for mental distress under Section 2-715 of the UCC on the ground that mental distress is a kind of personal injury.

Furthermore, in *Liberty Homes, Inc. v. Epperson,*[150] where the buyer purchased a mobile home which appeared defective, the buyer sought to recover $191,174.70, as damages, for mental distress, the cost of the mobile home and the expenses he incurred to move to another house. The cost of the mobile home was $25,982.50. Therefore, the claimed damages were mostly for the mental distress. The Supreme Court of Alabama allowed this claim for damages for mental distress. In this case, the Court made it clear that damages for mental distress are recoverable in cases where the parties contemplate that the breach will reasonably or necessarily result in such a distress. The Court added that this can be the case where the contractual duty is coupled with matters of mental concern or with the feelings of the party to whom the obligation is owed.

Damages for mental distress are awarded exceptionally. In other words, the court usually categorizes the case under an exception to the general rule of the non-recoverability of damages for mental distress. Such a rule applies under all the jurisdictions of the USA. To my knowledge, there has been no reported case where damages for mental distress were allowed under the normal restrictions without categorizing it under one of the exceptions to the general non-recoverability rule. However, such a rule may not apply strictly in all cases, especially in the State of Alabama. In the recent case of *Volkswagen of America, Inc. v. Dillard*,[151] where a buyer of a new car suffered anxiety and depression due to the car being unsafe to drive, the Supreme Court of Alabama upheld the award of $8000 for the mental distress caused by the defective quality of the car.[152] The Court stated that damages for mental distress are generally unavailable. The case was categorized under the exception that the seller's

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[149] 1977 U.S. Dist. LEXIS 13366; 23 UCC Rep. Serv. 47 (1977). The case involved a sale of a casket which was warranted to be water tight for three months. The casket appeared defective. It was held that the word 'person' embraces the mind as well as the body. Therefore, anxiety or depression does a damage to the person.

[150] 1991 Ala. LEXIS 350; 14 UCC Rep. Serv. 2d 1105 (1991).

[151] 1991 Ala. LEXIS 214; 14 UCC Rep. Serv. 2d 475 (1991). See R.A. Walker, 'Damages Recoverable for Mental Anguish arising from Breach of Warranty in the Sale of Automobile' (1992) 22 *Cumb. L. Rev.* 417.

[152] However, in *Joyce Ruth Wise v. General Motors Corp.* 1984 U.S. Dist. LEXIS 15275; 39 UCC Rep. Serv. 900 (1984) the plaintiff could not recover damages for mental distress caused by breach of warranties in contract for sale of automobile.

contractual obligation was coupled with mental concern or solicitude or with the feelings of the buyer. In fact, it is very hard to see why the case was categorized under such an exception. Most likely, the case was decided exceptionally under its own facts. The seller, in this case, admitted his liability for the anxiety suffered by the buyer.

To sum up, the rule of the general non-recoverability of damages for mental distress seems not to have a strict application in the American courts. In other words, the courts seem to be flexible in categorizing the cases under the exceptions to the rule where justice requires that. However, one cannot ignore the fact that the rule of the general non-recoverability of damages for mental distress is still applicable in the American courts. The rule seems to be a matter of policy. The following section will argue that there seems to be no point in disallowing compensatory damages for mental distress in cases where such a damage, i.e. the distress, complies with the normal restrictions imposed on the recovery of damages.

5.5.1.5 Final Note: the General Non-Recoverability Rule does not Comply with the Principle of *Robinson v Harman*

The restricted approach of awarding compensatory damages for mental distress apparently clashes with a basic principle of the common law. In *Robinson v. Harman,*[153] Parke B said that "[t]he rule of the common law is that where a party sustains a loss by reason of breach of contract he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."[154] Awarding the aggrieved party damages for mental distress seems to be the only available way to help him to recover from such a distress. By depriving him from receiving such damages, he cannot be put in the same situation that he would have been in if the contract had not been breached. Here, it seems that the approach of the courts in this respect is one of policy.[155] However, the courts left this policy unclear.[156]

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[153] (1848) 1 Exch. 850.
[154] *Robinson v. Harman,* (1848) 1 Exch. 850, 855.
[155] See the judgment of Staughton in *Hayes and another v James & Charles Dodd (a firm)* [1990] 2 All ER 815 at p.824.
[156] M P Furmston, 'Damages - Diminution in Value or Cost of Repair?- Damages for Distress' (1993) 6 *JCL* 64, 66. See also David Yates, 'Damages for Non-Pecuniary Loss' (1973) 36 *MLR* 535, 538.

It is true that damages for mental distress are hard to quantify. It seems very hard to give an accurate way of assessing the money value of non-pecuniary losses in general.[157] But this practical difficulty should not prevent the recovery in principle.[158] Damages for mental distress can be quantified in the same way of assessing other forms or heads of damages for non-pecuniary losses. A party who has broken his contract should not be permitted, in principle, to escape liability because of the difficulty of quantifying such damages. One may also suggest that mental distress is hard to prove. "But difficulties of proof cannot alter the legal principles"[159].

One may also argue that mental distress may always result from breach of contract and, hence, the buyer may always claim damages for such a distress. Consequently, the seller's cost of insurance may increase due to the increased risk of liability in case of breach; and as a result, the prices will rise. Well, it is doubtful that this would be the case in commercial contracts especially where the buyer is a company. The company has no feelings. In such a case, mental distress cannot be in the reasonable contemplation of the parties as not unlikely to result from the breach. Even in other commercial cases, allowing the buyer, as damages, his economic loss may relieve him.[160] However, the consumer buyer may suffer mental distress due to defective goods. Here it should be noted that the awards for mental distress are normally modest. In consumer cases, it is likely that parties to a consumer sale contract reasonably contemplate that mental distress is not unlikely to result from breach of warranty of quality. However, contrary to the opinion of Treitel,[161] the mere contemplation does indicate that the buyer accepts the

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[157] In *Chaplin v. Hicks* [1911] 2 KB 786, Fletcher Moulton LJ pointed out, at p.795, that "where it is clear there has been actual loss resulting from the breach of contract, which it is difficult to estimate in money, it is for the jury to do their best to estimate; it is not necessary that there should be an absolute measure of damages in each case. There are no doubt well-settled rules as to the measure of damages in certain cases, but such accepted rules are only applicable where the breach is one that frequently occurs. In such cases the Court weighs the pros and cons and gives advice, and I may almost say directions, to the jury as regards the measure of damages. This is especially the case in actions relating to the sale of goods for which there is an active and ready market. But in most cases it may be said that there is no recognized measure of damages, and that the jury must give what they think to be an adequate solatium under all the circumstances of the case."

[158] Nelson Enonchong , supra n.104 at p.629.

[159] *Malik v. BCCI* [1998] AC 20, 53 per Lord Steyn.

[160] D.J. Whaley, 'Paying for the Agony: the Recovery of Mental distress Damages in Contract Actions' (1992) 26 *Suffolk U. L. Rev.* 935, 954.

[161] G.H. Treitel, *Law of Contract,* 10th ed., 1999, 923. See also the American case of *Hatfield v. Max Rouse & Sons Northwest,* 1980 Ida. LEXIS 394; 100 Idaho 840 (1980). In this case, an auctioneer sold the plaintiff's property at an amount far less than that agreed upon. The plaintiff, as a result, suffered mental distress. It was held that plaintiff is not entitled to damages for his mental distress. The Court said "of course, the breach of any contract which the parties consider important predictably will lead to some mental distress. Life in the competitive commercial world has at least equal capacity to bestow ruin as benefit, and it is presumed that those who enter this world do so willingly, accepting the risk of

risk of mental distress. Indeed, "the injured party does not accept the risk of anxiety... any more than he accepts the risk of other damage."[162]

It can be argued that this will lead the court to open its door to any claim, however trivial, due to the fact that the breach may always cause trivial mental distress. However, triviality should not justify the prohibition of recovery in principle. Even if we accept such an opinion, one should not ignore cases where severe mental distress results from the breach. As previously mentioned, the American Restatement (Second) of contracts allows damages for severe mental distress. Strictly, it seems extremely unjust to disallow the buyer damages for severe mental distress resulting from breach of warranty of quality where such a non-pecuniary loss complies with the normal restrictions imposed upon the recovery of damages. The human is not only made of flesh and blood. The human is full of emotions and feelings that should be treated as part of the body. Indeed, as the United States District Court of Montana put it, "the person" includes mental states which may, like physical states, be injured as a consequence of a breach of warranty.[163] The recoverability of damages for physical loss is beyond question; thereupon, damages for mental distress should be recoverable. In this view, I do not find any justification for the anxiety of the courts, whether in England or the United States, regarding the recoverability of damages for mental distress resulting from a breach of contract.

Finally, it should be noted that the tendency of the English Court is not to award a large sum for such a loss. Damages for non-pecuniary losses "should be on a scale which is not excessive but modest."[164] Personally, I think that the buyer should not be entitled to excessive damages for mental distress resulting from the breach of warranty of quality. Of course, the amount of damages depends on whether the distress is normal or severe. However, where the distress does not cause any illness which requires treatment, it is

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encountering the former as part of the cost of achieving the latter. Absent clear evidence to the contrary we will not presume that the parties to a contract such as the one before us meant to ensure each other's emotional tranquility." However, with many respects, the question should be whether or not the aggrieved party accepted, at the time of making the contract, to suffer mental distress as a result of the breach by the other party. The mere fact that the breach may always cause mental distress does not, by itself, justify the denial of damages for such a mental distress.

[162] Nelson Enonchong, supra n.104 at p.630.

[163] *Hirst v. Elgin Mental Casket Co.* 1977 U.S. Dist. LEXIS 13366; 23 UCC Rep. Serv. 47 (1977). See A.M. Squillante and J.R. Fonseca, supra n.147 at p.978.

[164] *Watts and Another v. Morrow* [1991] 4 All ER 937, 945 per Ralph Gibson LJ.

hard to accept the large awards such as the awards in the aforementioned American cases.

Conclusions

The English courts seem to be strict in allowing damages for non-pecuniary losses such as mental distress. However, the buyer should be entitled to recover for all losses under the normal restrictions imposed on the recovery of damages. Ignoring certain types of non-pecuniary damage caused by the seller's breach means that the buyer will not be fully compensated under the principle of *Robinson v. Harman.*[165] It is submitted that damages should be allowed for mental distress under the normal restrictions. It was argued that mental distress is unlikely to result in commercial cases. Under English law, as it stands at present, damages for mental distress are exceptionally recoverable in cases where the contract is intended to provide mainly pleasurable amenity or free from distress or where mental distress follows from personal injury or physical inconvenience caused by the breach of contract.

A comparison between English law and American law shows that the latter has gone a step forward regarding the recoverability of damages for mental distress. The general non-recoverability rule exists in all the jurisdictions of the USA. The exceptions to this rule under English law can also be found in all the American jurisdiction. However, the American Restatement (Second) of Contracts takes a further step to allow such damages where the breach is of such a kind that serious emotional disturbance is a particularly likely result.

However, English courts seem to have better attitude than American courts in cases of physical inconvenience. Under English law, damages for physical inconvenience can be recovered under the normal restrictions imposed on the recovery of damages. However, there seems to be inconsistency among the several American jurisdictions regarding cases where physical inconvenience is not severe or does not follow from bodily injury. It is submitted that there is no reason to deal with cases of physical inconvenience differently. Under Section 2-714 of the UCC, damages should be allowed for the damage caused by the seller's breach of warranty. Therefore, damages for physical inconvenience should be allowed under the normal restrictions.

American law seems also to be different from English law in relation to the application of the remoteness principle. Unlike English law, American law does not apply the remoteness principles to cases of physical damage. Under Section 2-715(2-b) of the UCC, damages for physical damage can be recovered if such a damage proximately results from the breach. However, it was argued that ignoring the remoteness principle may lead to unlimited liability. This may increase the cost of production as the seller's insurance will be higher. Moreover, the seller will be in an insecure position as he will be liable for physical losses resulting under special circumstances, which he was not aware of at the time of making the contract.

Although English law, unlike American law, applies the remoteness principle to all types of loss resulting from defective quality, the principle may apply in tort and contract differently. Here, Lord Denning's view is to be preferred. It does not seem sensible to consider the same loss as not remote in tort and as too remote in contract. Indeed, where an action can be brought in contract or tort for the same loss, the remoteness principle should apply similarly under both actions.

As regards the CISG, it can be noted that the recoverability of damages for mental distress and physical inconvenience seems to be beyond the scope of its application. Comment 3 to Article 74 makes it clear that the purpose of damages is to compensate the aggrieved party for his financial loss. Therefore, the issue is left to be decided under the applicable domestic law. Furthermore, the recoverability of damages for personal injury is beyond the scope of the CISG. This can simply be understood from the words of Article 5 of the Convention. This is due to the differences between the different legal systems regarding the recoverability of damages for personal injury. Nevertheless, it is still debatable whether the buyer can claim damages, under the CISG, for his liability to the sub-buyer who suffered personal injury caused by the defective quality of goods. Some legal writers argue that such a claim is for money loss and not for personal injury; thus, it is within the scope of the Convention. However, it was argued that Article 5 excludes the applicability of the Convention to cases of personal injury suffered by any person. The sub-buyer may not be allowed to sue the seller under the Convention due to the application of the privity requirement. Therefore, it was submitted that the words of

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[165] (1848) 1 Exch. 850.

Article 5 can only be construed in a way to exclude the application of the Convention to cases where the buyer claims damages for his personal injury or for his liability to a third party who suffered personal injury caused by the defective quality of the goods. However, the exclusion of the applicability of the Convention under Article 5 does not include cases of property damage. Damages for property loss resulting from breach of warranty of quality can be recoverable under the normal restrictions imposed upon the recovery of damages.

Finally, this chapter dealt with the question of whether the buyer can claim damages in tort under the applicable domestic law in areas governed by the CISG. It was argued that the buyer should not be allowed to resort to the applicable domestic law in order to bring an action in tort in areas governed by the CISG. This opinion took into account the international aspect of the Convention and the purpose for which the Convention was founded. Allowing the buyer to bring a tort action under the applicable domestic law seems a direct attack on the uniformity purpose of the CISG. It is submitted that where the CISG is applicable, it becomes the only law which governs the dispute between the parties unless the area of the dispute is not within the scope of the CISG or the parties agree otherwise.

Chapter Six

Liability of Remote Seller:

Recoverability of Damages for Third Party's Loss

> "In the world of modern commerce, where people rely on nationally advertised brand names to buy goods that the retailer never altered, inspected, or recommended, it is realistic to say... that there is a bargain of sorts between buyer and manufacturer."[1]

Introduction

As the previous chapters were concerned with the proper amount of damages that the buyer should receive, this chapter takes a further step to ensure that the buyer is not left uncompensated for the losses caused by the defective quality of goods. The chapter argues that the strict application of the privity doctrine may leave the buyer uncompensated and allow the person responsible for the loss to escape liability. The privity requirement should be relaxed in order to ensure that the person responsible for the loss bears liability for it.

Buyers may be unaware of the defective quality of the goods that they sell to sub-buyers. Where the sub-buyer suffers physical loss, he may bring an action in tort against the original seller. This chapter will show that the privity restriction does not apply where the action is brought in tort. However, the tort action is not available in cases of purely economic loss resulting from defective goods. As will be discussed, damages for economic loss, which is not consequent on physical loss, can only be recovered in a contract action. There seem to be difficulties in determining what constitutes economic loss in cases of 'complex items'. Where the sub-buyer suffers economic loss, resulting from breach of warranty of quality, the question becomes whether the sub-buyer can bring a direct contract action against the seller. (Diagram A) In answering this question, it seems necessary to see whether the Contracts (Rights of Third Parties) Act 1999 applies to sale of goods cases.

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[1] *Moorman Mfg. Co. v. National Tank Co.*, 91 Ill. 2d 69, 99 (1982) per Simon J.

Where warranties are issued by parties to string contracts, liability for breach of such warranties may pass up the chain until it reaches the original seller. However, in certain cases, liability cannot reach the original seller through this method and, as a result, the original seller escapes liability. Such a method may lead to unfairness in some cases. Some of the American jurisdictions avoid such a method by relaxing the rigour of the requirement of privity. In certain cases, such jurisdictions allow the ultimate buyer to file a claim in contract against the remote seller. It is intended to find out whether the remote seller should be liable for losses suffered by the ultimate buyer due to breach of implied or express warranty.

In modern commerce, ways of marketing products are rapidly increasing. Manufacturers may warrant the quality of their products through advertisements in order to promote their purchase. Manufacturers may use wide expressions that may be misleading. In most cases, the enforceability of the remote seller's representation is uncertain. It is intended to prove that the remote seller should be contractually liable for breach of his representation regarding the quality of the goods. (Diagram B) The remote seller can be a manufacturer, importer, wholesaler, distributor or any seller in chain contracts who is not privy to the purchase contract with the ultimate buyer.

Beneficiaries, other than the ultimate buyer, are not in a direct contractual relationship with the retailer. Can the warranty, issued by a retailer, extend to other beneficiaries? Can the ultimate buyer recover damages for losses suffered by a third party beneficiary? (Diagram C) In answering this question, one needs to consider the decision of the House of Lords in *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.*[2] Where the remote seller's warranty is legally binding, can beneficiaries, other than the ultimate buyer, sue the remote seller under the warranty theory? (Diagram D)

[2] [1994] 1 AC 85.

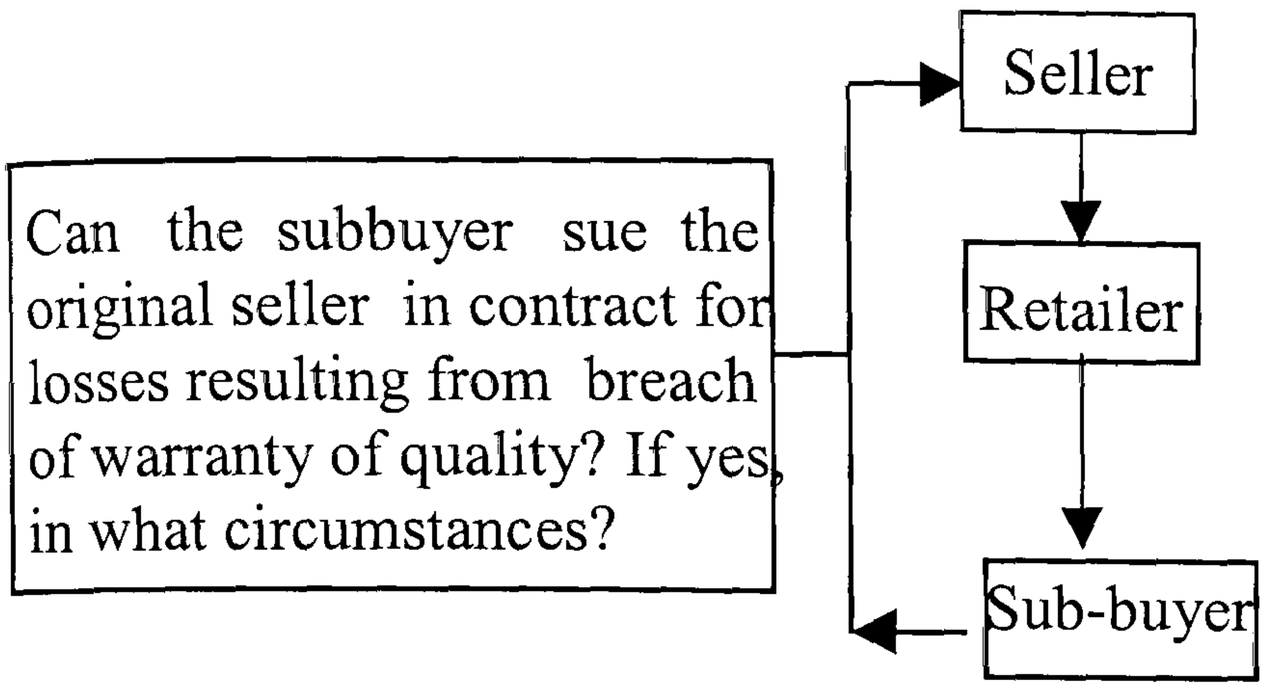

Diagram A

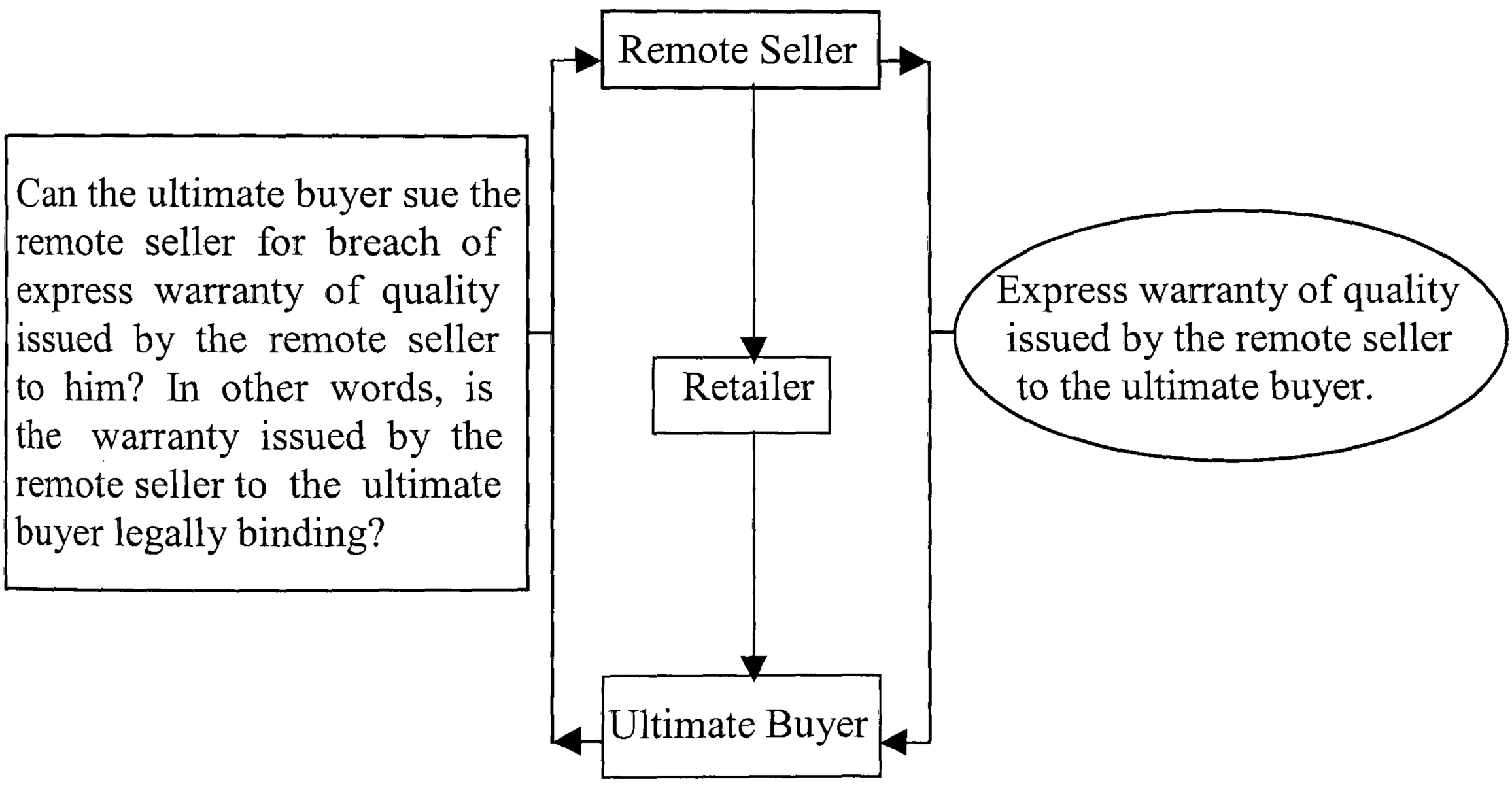

Diagram B

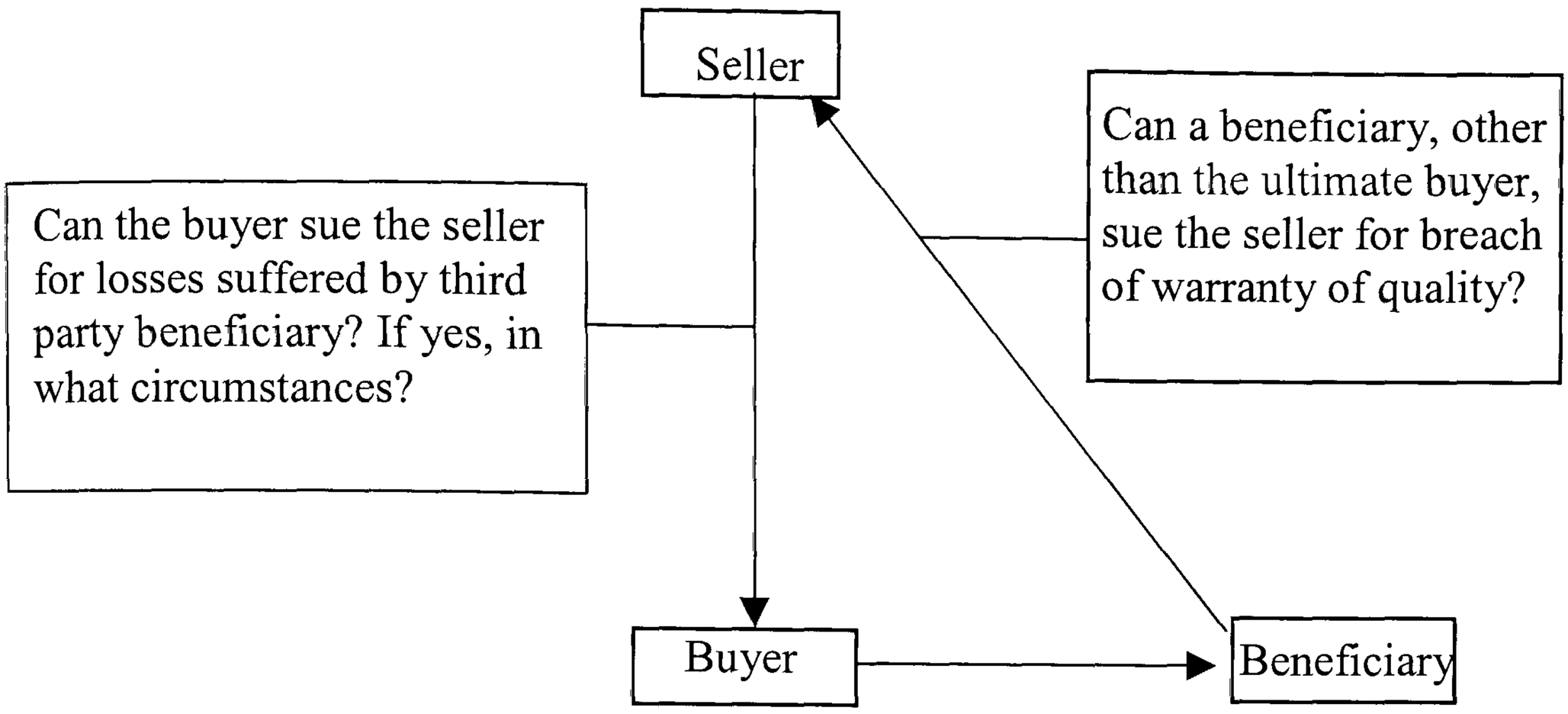

Diagram C

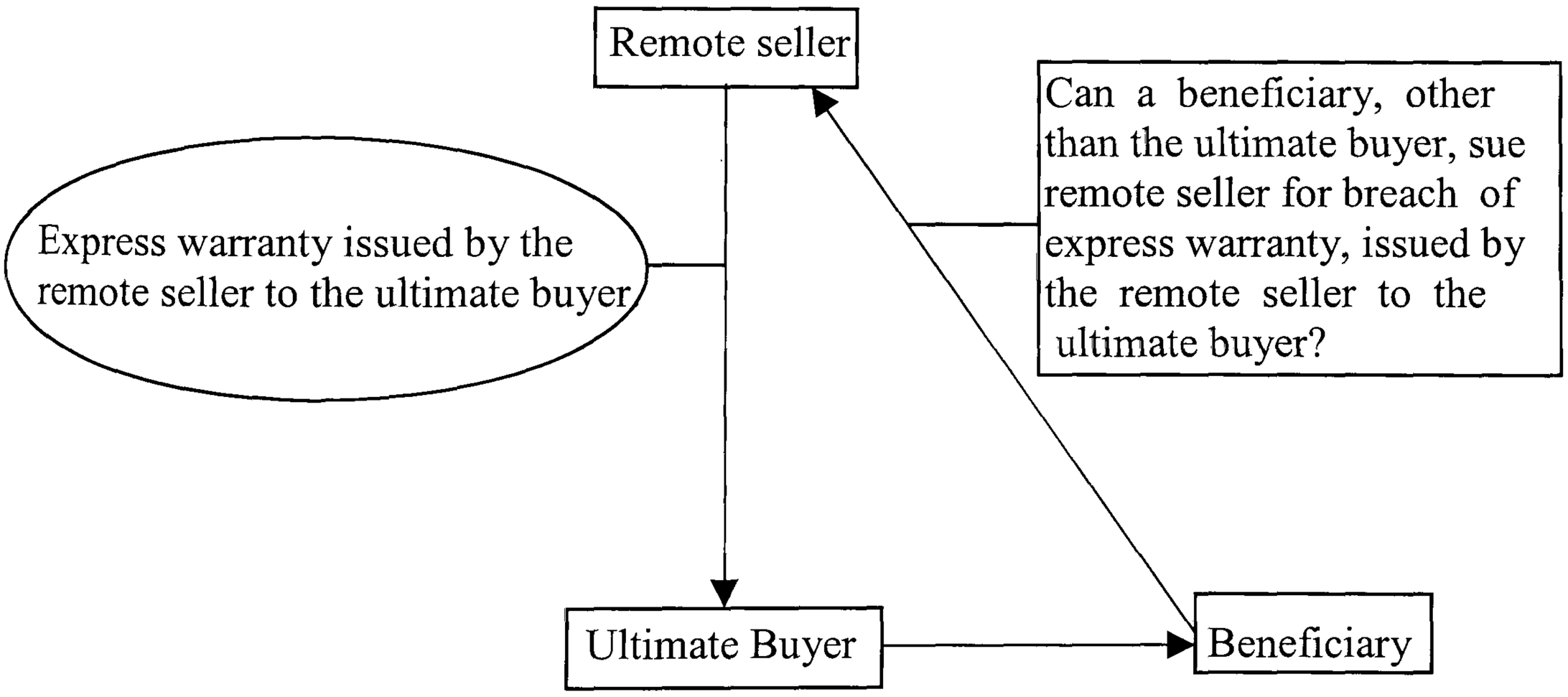

Diagram D

6.1 Liability of Remote Seller for Losses Suffered by the Ultimate Buyer

Under the classic rules of contract law, the aggrieved party cannot bring a contract suit unless he is a privy to the breached contract.[3] In *Winterbottom v. Wright*,[4] where an injured coachman sued a third party who had contracted to maintain the coach, the Court rejected the claim on the ground of lack of privity. In this case, Lord Abinger pointed out that unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit, would ensue.[5] The privity requirement, stated in this case, was carried by American jurists into cases of claims against remote sellers.[6] The doctrine of privity in contract law has become firmly established in *Tweedle v. Atkinson*[7] where a third party could not enforce a contract made for his benefit.

The privity doctrine does not apply in tort. Therefore, where the ultimate buyer suffers physical loss, resulting from breach of warranty of quality, he may sue the remote seller in tort. In the landmark case of *Donoghue v. Stevenson*[8] the House of Lords held that the manufacturer may be liable for a third party for physical injury caused by his defective products. In this case, Lord Atkin restricted the applicability of *Winterbottom v. Wright,*[9] to cases where the aggrieved party brings a claim in contract. In this sense, one may state that the impact of *Donoghue* is to disallow the application of privity doctrine to tort cases and insists on its application to contract cases. In distinguishing the case of *Winterbottom,* Lord Atkin pointed out that "[i]t is to be observed that no negligence apart from breach of contract was alleged—in other words, no duty was alleged other than the duty arising out of the contract.... The argument of the defendant was that... the wrong arose merely out of the breach of a contract and that only a party to the contract

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[3] However, such privity requirement may not apply in certain States of the USA. See infra p.253. See, for example, *Ferguson v. Sturm, Ruger & Co.*, 33 UCC Rep. Serv. 548 (D.Conn. 1981); *Lang v. General Motors Corporation,* 1967 N.D. LEXIS 128; 136 N.W. 2d 805 (1967); *Hiles Co. v. Johnston Pump Co.,* 1977 Nev. LEXIS 476; 21 UCC Rep. Serv. 568 (1977); *Kassab v. Central Soya,* 1968 Pa. LEXIS 507; 5 UCC Rep. Serv. 925 (1968).

[4] [1842] 10 M. & W. 110; 152 ER 402.

[5] *Winterbottom v. Wright,* [1842] 10 M. & W. 110; 152 ER 402, 405.

[6] W.K. Lewis, 'Towards a Theory of Strict "Claim" Liability: Warranty Relief for Advertising Representations' 47 *Ohio St. L.J.* 671, 673. See the UCC case of *Hardesty v. Andro Corp.-Webster Div.* 555 P.2d 1030 (Okla. 1976), where the owner of an apartment building contracted with the a subcontractor for installation of an air conditioning system, the owner could not sue the manufacturer under the warranty theory due to the application of the privity doctrine. See also *Gold'n Plump Poultry, Inc. v. Simmons Engineering Co.* 805 F.2d 1312 (8th Cir. 1986); *Morrow v. New Moon Homes, Inc.* 548 P.2d 279 (Alaska 1976).

[7] (1861) 1 B & S 393.

[8] [1932] AC 562.

[9] [1842] 10 M. & W. 110; 152 ER 402.

could sue."[10] This rule can be found under Section 402A of the Restatement (Second) of Torts, which allows the ultimate buyer in certain cases to sue the manufacturer for physical losses suffered by defective goods.[11]

Where physical damage results from breach of contract, the aggrieved party may have the choice to sue in contract, tort or both.[12] The question here is whether there is a contractual relationship between the remote seller and the ultimate buyer. As discussed below, in most cases, the answer to this question seems to be in the negative. Clearly, in the absence of such a contractual relationship, the ultimate buyer may not be left without remedy for his physical loss caused by the defective quality of the goods. In such a case, he may bring an action in tort against the remote seller. Under the Consumer Protection Act 1987 (henceforth CPA) the buyer need not prove negligence. In other words, the liability of the remote seller under the CPA is strict. As the CPA is concerned with the safety of the goods, it has no application to cases where the buyer suffers purely economic loss.

It seems well settled that where economic loss is consequent on physical loss, the buyer may bring a tort action for such an economic loss.[13] However, the buyer is not entitled to recover damages in tort for purely economic loss.[14] Therefore, the only way for the

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[10] *Donoghue v. Stevenson* [1932] AC 562, 589.

[11] Section 402A(1) of the Restatement (Second) of Torts states: "... One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if (a) the seller is engaged in the business of selling such a product, and (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold...". See R.E. Speidel, 'Product Liability, Economic Loss and the UCC' (1973) 40 *Tennessee Law Review* 309; R.G. Fehrenbacher, 'Product Liability: Recovery of Economic Loss in California' (1977) 13 *Cal. W. L. Rev.* 297, 299.

[12] In the recent case of *Henderson v. Merrett Syndicates Ltd.* [1995] 2 AC 145, the House of Lords made it clear that the aggrieved party may have the choice to sue in tort and contract for the same loss.

[13] See *Muirhead v. Industrial Tank Specialities Ltd. and Others*, [1986] 1 QB 507. As for the American law, see, as an example, *Signal Oil & Gas Co. v. Universal Oil Products*, 572 S.W. 2d 320; 24 UCC Rep. Serv. 555 (Tex. 1978) where it was held that damages for economic loss consequent on physical damage, resulting from a breach of contract, can be awarded under the strict liability theory.

[14] See *Murphy v. Brentwood District Council* [1991] 1 AC 398; *D. & F. Estates Ltd. v. Church Commissioners* [1989] AC 177. See also D. Beyleveld and R. Brownsword, 'Privity, Transitivity and Rationality' (1991) 54 *MLR* 48, 49. Under the American law, this was made clear in the decision in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 752 F.2d 903 (3d Cir. 1985) where the Court made it clear that damages for purely economic loss are not available in tort. See also *Arkwright-Boston Manufacturers Mutual Insurance Co. v. Westinghouse Electric Corp.*, 844 F.2d 1174, 6 UCC Rep. Serv. 2d 73 (5th Cir. 1988); *Shipco 2295, Inc. v. Avondale Shipyards, Inc.*, 825 F.2d 925, 5 UCC 2d 59 (5th Cir. 1987); *King v. Hilton-Davis,* 855 F.2d 1047, 6 UCC2d 1424 (3d Cir. 1988); *Nobility Homes of Texas, Inc. v. Schivers,* 557 S.W.2d 77, 22 UCC Rep. Serv. 621 (Tex. 1977); T.A. Diamond and H. Foss, 'Consequential Damages for Commercial Loss: An Alternative to *Hadley v. Baxendale'* (1994) 63 *Fordham L. Rev.* 665, 676; Stephen J. Leacock, 'A General Conspectus of American Law on Product Liability' in *American Business Law,* 1989, 273 at 278; C.S. D'Angelo, 'the Economic Loss Doctrine:

buyer to recover for his economic loss is to bring an action in contract. The case may be complicated where the buyer suffers physical and economic losses resulting from the breach of warranty of quality. Where the goods are defective, the buyer may suffer economic loss which consists of the diminution in value of the goods[15] and any loss of profit resulting from the deficiency in the productive capacity of the goods. The buyer may also suffer physical loss resulting from the defective quality of the goods and financial loss consequent on such a physical loss. The question here is whether the buyer can bring a tort action to recover for all such losses. This issue rose in *Muirhead v. Industrial Tank Specialities Ltd. and Others*.[16] In this case, the plaintiff was a wholesale fish merchant. He had entered into a contract for the installation of pumps in order to use them in his lobster farm. The pumps did not function properly due to their defective quality. As a result the plaintiff lost his entire stock of lobsters. The plaintiff brought an action in tort against *inter alia* the manufacturer, who had supplied the electrical motors for the pumps, to recover for his physical damage, i.e. the loss of stock, and his economic loss. The Court of Appeal awarded the plaintiff damages for his physical loss and the financial loss that was consequent on the physical loss, i.e. the loss of the stock of lobsters and the loss of profit on the sale of the lost lobsters. However, the plaintiff's claim for purely economic loss was not successful. The Court did not allow the plaintiff to recover damages for the diminution in value of the pumps and loss of profit that he would have made from the installation if the pumps had been free of defects. The Court held that damages for purely economic loss are not available in tort.

It is obvious that the buyer cannot bring an action in tort to recover damages for the diminution in value of the goods supplied.[17] This was well explained by Lord Bridge of Harwich in *Murphy v. Brentwood District Council.*[18] In this case, the plaintiff purchased a semi-detached house from a construction company. The house was constructed on a concrete raft foundation. The plans and calculations for the raft foundations were

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Saving Contract Warranty Law from Drowning in a Sea of Torts' (1995) 26 *U. Tol. L. Rev.* 591, 592; D.B. Gaebler, 'Negligence, Economic Loss, and the UCC' (1986) 61 *Ind. L.J.* 593, 623.

[15] Under English law and all the American jurisdictions, damages cannot be recovered in tort for diminution in value of the goods supplied. See K.S. French, 'Tort and Contract: Pennsylvania Denies a Products Liability Claim for Economic Loss resulting from a Product Damaged as a Result of its own Defect' (1989) 9 *J. L. & Com.* 99.

[16] [1986] 1 QB 507.

[17] In cases where the goods deteriorate due to their own defect, the buyer may not recover in tort for such a loss. The only loss here is economic which cannot be compensated in tort. See A.G. Guest, *Chitty on Contracts,* London, Vol.1, 28th ed., 1999, para.19-033.

[18] [1991] 1 AC 398.

approved by the local council. The house appeared seriously defective due to serious cracks; the house foundation appeared defective and the differential settlement beneath it had caused it to distort. The plaintiff brought an action against the council claiming that it was liable for the consulting engineers' negligence in recommending approval of the plans and alleging that he and his family had suffered an imminent risk to health and safety because gas and soil pipes had broken and there was a risk of further breaks. The House of Lords held that the plaintiff's loss was purely economic as dangerous defect once known became merely a defect in quality, which is purely economic loss. Damages for such a loss cannot be recovered in a tort action. In this case, Lord Bridge of Harwich said

> "[i]f a manufacturer negligently puts into circulation a chattel containing a latent defect which renders it dangerous to persons or property, the manufacturer, on the well-known principles established by *Donoghue v Stevenson* [1932] AC 562, [1932] All ER 1, will be liable in tort for injury to persons or damage to property which the chattel causes. But if a manufacturer produces and sells a chattel which is merely defective in quality, even to the extent that it is valueless for the purpose for which it is intended, the manufacturer's liability at common law arises only under and by reference to the terms of any contract to which he is a party in relation to the chattel; *the common law does not impose on him any liability in tort to persons to whom he owes no duty in contract but who, having acquired the chattel, suffer economic loss because the chattel is defective in quality. If a dangerous defect in a chattel is discovered before it causes any personal injury or damage to property, because the danger is now known and the chattel cannot be safely used unless the defect is repaired, the defect becomes merely a defect in quality.* The chattel is either capable of repair at economic cost or it is worthless and must be scrapped. In either case the loss sustained by the owner or hirer of the chattel is purely economic. It is recoverable against any party who owes the loser a relevant contractual duty. *But it is not recoverable in tort in the absence of a special relationship of proximity imposing on the tortfeasor a duty of care to safeguard the plaintiff from economic loss. There is no such special relationship between the manufacturer of a chattel and a remote owner or hirer.*"[19] [Emphasis added]

Two main questions may be raised by the decision in *Murphy*. Firstly, What does purely economic loss mean in the context of complex structure or complex chattel? Secondly, where expenses incurred to avoid risk of property damage, can such expenses be recovered in a tort action?

In complex structure or complex chattel, a defective part of a structure or chattel may cause damage to another part of the same structure or chattel. The question here is

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[19] Ibid, p.475.

whether such a damage can be regarded as a purely economic loss or as a damage to other property for the purpose of application of *Donoghue v. Stevenson*[20] principle.[21] In *Murphy* Lord Bridge of Harwich distinguished between two parts of the structure, i.e. the part which can be regarded as part of the structure itself, such as the foundations of building and the part which is incorporated in the building such as a boiler or electrical installation.[22] Under such a distinction, the damage caused to the whole structure by the failure of the first part can be regarded as economic loss whereas the damage caused to the structure by the failure of the second part can be regarded as property damage for the purpose of application of *Donoghue* principle. Therefore, where a television explodes and causes damage to the buyer's property, the buyer may bring a tort action against the manufacturer to recover for the property damage.

Applying the distinction drawn by Lord Bridge of Harwich to cases of sale of "complex items" may not be as easy as in cases of complex structure. For example, suppose that due to a defective tyre of a car, the car was damaged. Can the buyer of the car sue the manufacturer of the tyre for the damaged car? Under the classification of Lord Bridge of Harwich, if the defective foundations of a house caused damage to the whole house, the damage will be regarded as purely economic loss which cannot be recovered in a tort action.[23] In this sense, the damage caused to the car by the defective tyre may be considered as purely economic loss. However, one may argue that in sale of "complex

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[20] [1932] AC 562.

[21] Supra, p.202.

[22] Lord Bridge of Harwich, in *Murphy v. Brentwood District Council* [1991] 1 AC 398, 478, said "[a] critical distinction must be drawn here between some part of a complex structure which is said to be a 'danger' only because it does not perform its proper function in sustaining the other parts and some distinct item incorporated in the structure which positively malfunctions so as to inflict positive damage on the structure in which it is incorporated. Thus, if a defective central heating boiler explodes and damages a house or defective electrical installation malfunctions and sets the house on fire, I see no reason to doubt that the owner of the house, if he can prove that the damage was due to the negligence of the boiler manufacturer in the one case or the electrical contractor in the other, can recover damages in tort on *Donoghue v Stevenson* principles. But the position in law is entirely different where, by reason of the inadequacy of the foundations of the building to support the weight of the superstructure, differential settlement and consequent cracking occurs. Here, once the first cracks appear, the structure as a whole is seen to be defective and the nature of the defect is known."

[23] However, the innocent party may recover for purely economic loss in a tort action where there is a special relationship of proximity between him and the party in breach. In *Murphy v. Brentwood District Council* [1991] 1 AC 398, Lord Bridge of Harwich, at pp.480-1, said "a building owner can only recover the cost of repairing a defective building on the ground of the authority's negligence in performing its statutory function of approving plans or inspecting buildings in the course of construction if the scope of the authority's duty of care is wide enough to embrace purely economic loss.... There may, of course, be situations where, even in the absence of contract, there is a special relationship of proximity between builder and building owner which is sufficiantly akin to contract to introduce the element of reliance so that the scope of the duty of care owed by the builder to the owner is wide enough to embrace purely economic loss."

items" contracts, the court may reach a different conclusion, especially where the items were manufactured by several manufacturers. This was the case of *Aswan Engineering Co. v. Lupdine Ltd.*[24] In this case, the plaintiffs bought a consignment of liquid waterproofing compound in plastic pails for shipment to Kuwait. The pails were stacked in shipping containers. On arrival in Kuwait, the containers were left standing on the quayside in full sunshine. The temperature inside the containers became too high and, as a result, the pails collapsed. Consequently, the entire consignment was lost. The plaintiff brought a tort action against the manufacturer of the pails to recover for the lost consignment caused by the collapse of the pails. The question, discussed by the Court of Appeal, was whether the loss of the liquid caused by the collapse of the pails was damage to other property.

In answering this question, Lloyd LJ considered similar cases. He said "[i]f I buy a defective tyre for my car and it bursts, I can sue the manufacturer of the tyre for damage to the car as well as injury to my person. But what if the tyre was part of the original equipment? Presumably the car is *other* property of the plaintiff, even though the tyre was a component part of the car, and property in the tyre and property in the car passed simultaneously. Another example, perhaps even closer to the present case, would be if I buy a bottle of wine and find that the wine is undrinkable owing to a defect in the cork. Is the wine other property, so as to enable me to bring an action against the manufacturer of the cork in tort?.... My provisional view is that in all these cases there is damage to other property of the plaintiff"[25]. According to the view of Lloyd LJ, if the electrical motors, in the case of *Muirhead* discussed above,[26] caused damage to the pumps, the buyer could have recovered damages from the manufacturer of the motors for such a damage. Lloyd LJ stated a provisional view as damages claimed were not recoverable, anyhow, due to the fact that the loss was too remote.

The case of *Aswan* was not referred to in *Murphy*. However, in the recent case of *Losinjska Plovidba v. Transco Overseas Ltd. and others (The "Orjula")*[27] the Court refused to rely on the view of Lloyd LJ in *Aswan*. The facts of *Orjula* were as follows. The plaintiff was a bareboat charterers of the vessel Orjula operating a liner service

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[24] [1987] 1 WLR 1.
[25] Ibid, p.21.
[26] Supra, p.204.
[27] [1995] 2 Lloyd's Rep. 395.

between England and Libya. Two containers were delivered to the plaintiff in order to be shipped to Libya. The containers were filled with drums of chemicals. The drums were not properly stored in the containers. As a result, there was a leakage of chemicals which caused damage to the containers and the vessel. The plaintiff sued *inter alia* the shipper (first defendant) and the supplier of the drums of chemicals (second defendant). As against the second defendant, the plaintiff alleged that the second defendant failed to lash, stow and/or secure the drums of chemicals within the containers in such a manner as to enable them to withstand the ordinary risks of transport by sea. The plaintiff relied on the view of Lloyd LJ in *Aswan* in order to recover damages in a tort action for the damage caused to the containers. The plaintiff submitted that the damage to the containers should be considered as damage to *other* property. However, the Court rejected this submission on the ground that the decision in *Murphy* seems to disapprove the view of Lloyd LJ.[28] However, the Court distinguished Murphy on the ground that in the present case the plaintiff *directly or indirectly* supplied the containers to the second defendant. "The plaintiff's interest in the containers is not therefore a subsequent interest deriving from the fact that the second defendant put them into circulation. It is a prior interest".[29] Thereupon, the Court held that the damage to the containers was considered as damage to other property. The second defendant was held liable for such a damage.

In the light of the decisions in *Murphy* and *The Orjula*, one may state that in cases of sale of "complex items", where a defective item causes damage to another item of the goods, the damage caused is the diminution in value of the whole goods, i.e. purely economic loss. Of course, this would not apply where the defective item is bought under a separate contract. If this becomes the case, the damage caused by such an item to the other items can be regarded as damage to another property.

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[28] In *Losinjska Plovidba v. Transco Overseas Ltd. and others (The "Orjula")* [1995] 2 Lloyd's Rep. 395, Mance J, at p.401, said "I was referred on this respect to dicta in opposing directions in the Court of Appeal in *Aswan Engineering Co Ltd v Lupdine Ltd,* [1986] 2 Lloyd's Rep 347; [1987] 1 WLR 1, per Lord Justice Lloyd at p 365, col 1; p 21B-H and per Lord Justice Nicholls at p 365, cols 1 and 2; pp 28H-29G. Lord Justice Lloyd expressed the provisional view that a purchaser of a compound in pails might claim in tort for loss of the compound due to a defect in the pails. Lord Justice Nicholls doubted this, and his view appears to acquire further force in the light of the subsequence decision in *Murphy*."

[29] *Losinjska Plovidba v. Transco Overseas Ltd. and others (The "Orjula")* [1995] 2 Lloyd's Rep. 395, 401.

However, the aforementioned classification[30] of Lord Bridge of Harwich in *Murphy* seems difficult to apply in certain cases. For example, if I buy a computer with extra speakers and due to a defect in the speakers the whole computer is damaged. Is the damage to the computer property damage or purely economic loss? The answer depends on whether such speakers can be considered as part of the computer which sustains the other parts or just an item incorporated in the computer to use it for certain purposes. Under the classification of Lord Bridge of Harwich, the damaged computer can be considered as a diminution in value of the computer, i.e. purely economic loss, where the speakers can be considered as part of the computer which sustains the other parts. However, such a damage may be considered as property damage if the speakers are considered as part which is incorporated in the computer for certain purposes. The same confusion appears in a case where the buyer purchases a computer with modem in order to connect the computer with the Internet. In view of the decision in *The Orjula,* the court may deal with the computer and other items as one unit and, as a result, any damage to the computer caused by such items may be considered as purely economic loss. Personally, I prefer the view of Lloyd LJ in *Aswan.* If I buy the computer and the modem under two separate contracts, the damage to the computer due to the defective modem can be always considered as property damage for the purpose of application of *Donoghue* principle. So, why should the same damage be considered economic loss where the computer and the modem are bought under one contract? In view of that, it is submitted, the court should pay more attention to the view of Lloyd LJ in *Aswan.*

The second question raised by the decision in *Murphy* is whether the buyer can recover expenses incurred in order to avoid risk of physical damage. In *Anns v. Merton London Borough,*[31] the damages allowed by the House of Lords included expenses to restore the building to a condition in which it is no longer an imminent danger to health or safety. The House of Lords in *Murphy* overruled its decision in *Anns* and the decision of the Court of Appeal in *Dutton v. Bognor Regis United Building Co Ltd and Another.*[32] As

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[30] Supra, p.206.

[31] [1977] 2 All ER 492. The case involved a claim by the plaintiffs against the council for their breach of duty of care to approve the plans for construction of a building. The facts of the case are similar to those of *Murphy v. Brentwood District Council* [1991] 1 AC 398 in which the House of Lords overruled its decision in *Anns*. In *D. & F. Estates Ltd. v. Church Commissioners* [1989] AC 177, Lord Bridge of Harwich also criticised the decision in *Anns* but he preferred not to provide any concluded view since the case of *D. & F. Estates* did not involve a claim against the council. In that case, the claim was against *inter alia* the builder. The damage to the house was held purely economic loss.

[32] [1972] 1 All ER 462. The case of *Dutton* involved a claim in tort against a builder of a house for the defective building and against the local authority (the council) for breach of duty of care in inspecting the

discussed above, in *Murphy* it was held that once the defect is discovered, it becomes economic loss. In such a case, the plaintiff will not be able to recover for any physical loss caused by the defect after the plaintiffs have discovered such a defect. The expenses incurred in avoiding the risk of physical damage were considered in *Murphy* as purely economic loss.[33] As previously mentioned, Lord Bridge of Harwich stated that "[i]f a dangerous defect in a chattel is discovered before it causes any personal injury or damage to property, because the danger is now known and the chattel cannot be safely used unless the defect is repaired, the defect becomes merely a defect in quality."[34] However, Lord Bridge of Harwich stated one exception to his view. Where a dangerous defect of the structure is "a potential source of physical damage to persons or property on neighbouring land or on the highway, the building owner ought, in principle, to be entitled to recover in tort from the negligent builder the cost of obviating the danger, whether by repair or by demolition, so far as that cost is necessarily incurred in order to protect himself from potential liability to third parties."[35]

In all cases, the decision in *Murphy* should not affect the recoverability of the expenses incurred in mitigating a present property damage. In such a case, although the expenses incurred are economic loss, the buyer will be entitled to recover such expenses in a tort action on the ground that the expenses incurred in order to mitigate a present property damage. For example, in the aforementioned case, *The Orjula,* the plaintiff was successful in his tort action to recover, as damages, the cost of preventing the leakage of some containers. The plaintiff incurred such expenses in order to mitigate the damage to the vessel, which was carrying the defective containers. In this case, it was made clear that damages for economic loss can be available in tort where such a loss flows from or is incurred in mitigating physical damage. The case of *Murphy* was distinguished on the ground that in *Murphy* the expenses were incurred to avoid the risk of physical damage. Therefore, the buyer may recover in tort the cost of repair of the goods supplied if such a repair was made to mitigate present damage to other property.

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building. The claim against the builder was settled as the builder was exempted from liability for negligence. The council was held liable for the cost of the repairing the house. The damage to the house was considered as physical damage. Obviously, this decision was overruled by the decision in *Murphy*.

[33] *Murphy v. Brentwood District Council* [1991] 1 AC 398, pp.479-80.

[34] Ibid, p.475.

[35] Ibid, p.475.

At the last point of this discussion, one cannot ignore the decision of the House of Lords in *Junior Books Ltd. v. Veitchi Co. Ltd.*[36] In this case, the plaintiff brought a successful action in tort to recover for purely economic loss. The facts of this case are well known. B had undertaken to build a factory for C under a contract which entitled C to nominate a sub-contractor. C nominated A who, as a result, entered into contract with B. The floor appeared defective and, consequently, C brought an action in tort against A for such defective performance. The House of Lords awarded C damages for such an economic loss, i.e. the cost of replacing the floor and other items of economic loss consequent on such replacement. The decision in this case seems to be an exception to the general rule that damages are not available in tort for purely economic loss. It has been suggested that this case was decided on its own facts.[37] In this case, there was a special relation between A and C as the latter nominated A. Indeed, subsequent decisions prove that damages for purely economic loss are not available in tort.[38] In fact, one may find a way to argue that there was a collateral contract between A and C in *Junior Books*. The main question here is whether the consideration requirement is satisfied. Obviously, C had conferred a benefit on A by offering him the opportunity to contract with B. In return, C was required to perform his contract with B properly. Therefore, one may argue that C could have brought an action in contract against A in order to recover for his economic loss. However, the action was brought in tort and exceptionally damages for economic loss were awarded.

In the light of the above discussion, one may need to direct the arguments in this chapter to cases where the buyer suffers purely economic loss, i.e. diminution in value and loss

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[36] [1983] 1 AC 520.

[37] In *Muirhead v. Industrial Tank Specialities Ltd. and Others,* [1986] 1 QB 507, Robert Goff LJ, at p.528, pointed out that "... it is, I think, safest for this court to treat *Junior Books* as a case in which, on its particular facts, there was considered to be such a very close relationship between the parties that the defenders could, if the facts as pleaded were proved, be held liable to the pursuers. I feel fortified in adopting that approach by three matters. First, Lord Fraser stressed that he was deciding the appeal before him 'strictly on its own facts' (see [1982] 3 All ER 201 at 204, [1983] 1 AC 520 at 533). Second, in the advice of the Privy Council in *Candlewood Navigation Corp Ltd v Mitsui OSK Lines Ltd, The Mineral Transporter, The Ibaraki Maru* [1985] 2 All ER 935, [1985] 3 WLR 381 Lord Fraser, who delivered the advice, appears to have treated *Junior Books* as a decision of limited application. Third, both Lord Fraser and Lord Roskill in *Junior Books* gave examples which assist us in approaching the present case on a pragmatic basis. For Lord Fraser considered that the very close proximity between the parties in his view distinguished the case before him from *'the case of producers of goods to be offered for sale to the public'* (see [1982] 3 All ER 201 at 204, [1983] 1 AC 520 at 533) and Lord Roskill contrasted cases in which... there was reliance by the plaintiff on the defendant with *cases of claims by ultimate purchasers against manufacturers in respect of goods purchased under ordinary everyday transactions where 'it is obvious that in truth the real reliance was on the immediate vendor and not on the manufacturer'* (see [1982] 3 All ER 201 at 214, [1983] 1 AC 520 at 547)." [Emphasis added]

of profit which is not consequent on physical damage. In such cases, the buyer will have no choice other than suing the remote seller in contract in order to recover damages for such losses. Bringing a contract action against the remote seller may not be always possible due to the lack of vertical privity. The expression of "vertical privity" is used in this work to describe the relationship between parties in distributive chain contracts. In cases of other losses, i.e. physical loss and economic loss consequent on physical loss, the buyer may find an alternative way of recovery by bringing an action in tort through negligence or under the CPA.

Where the loss results from breach of express warranty issued by the remote seller to the ultimate buyer, the question becomes whether such a warranty is enforceable or not. The SGA, the UCC and the CISG do not deal expressly with the enforceability of warranties issued by the remote seller to the ultimate buyer. Under the SGA, the issue is clearly left to the case law. The applicability of the UCC and the CISG to such warranties is uncertain. Anyhow, such a warranty can be enforceable in cases where it furnishes a ground for collateral contract between the remote seller and the ultimate buyer. However, as discussed below, one of the requirements for making a contract is consideration, which does not seem easy to find in cases of collateral relationship.[39] A contractual relationship between the remote seller and the ultimate buyer is too hard to be found where there is no express warranty issued by the remote seller to the ultimate buyer. In such a case, it seems hard to find a legal ground for holding the remote seller liable for losses suffered by the ultimate buyer, especially where the loss suffered is purely economic.

To deal with this issue, i.e. the liability of the remote seller to the ultimate buyer, one needs to start with the Contracts (Rights of Third Parties) Act 1999. At this place the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees[40] cannot be ignored.

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[38] *Murphy v. Brentwood District Council* [1991] 1 AC 398; *D. & F. Estates Ltd. v. Church Commissioners* [1989] AC 177.

[39] R.A. Anderson, I. Fox and D.P. Twomey, *Business Law*, 1988, p.251.

[40] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, Official Journal L 171, 07/07/1999 p.0012 – 0016.

6.1.1 The Applicability of the Contracts (Rights of Third Parties) Act 1999 to Cases of Defective Goods

The Contracts (Rights of Third Parties) Act 1999 (henceforth the 1999 Act) was enacted in order to ensure that the agreement between the parties is legally enforceable.[41] Before the 1999 Act came into force, the contract term which entitles a third party to enforce the contract was not legally enforceable.[42]

The significance of the 1999 Act is that it fills an obvious gap in the common law. The promisor's breach may cause economic loss to third party. In this case, the person who suffers the loss, i.e. the third party, may not have a contract action and the person who can bring such an action, i.e. the promisee, does not suffer any loss. Now, under the 1999 Act, the third party may bring a contract action against the promisor to recover for his own loss. Exceptionally, the promisee may be allowed to recover damages for losses suffered by a third party.[43] This exception is not dealt with by the 1999 Act. However, subject to certain restrictions discussed below, such exception is still available even after the 1999 Act came into force.[44] In all cases, such exception will not be available where the third party has a cause of action. Therefore, the buyer may not rely on this exception to recover damages for losses suffered by his sub-buyer due to defective goods. This is due to the fact that the sub-buyer has a contract action against the buyer who may recover for his liability to such a sub-buyer from his direct seller. Furthermore, in cases where the buyer purchases goods in order to give them to a third party as a gift, the application of such an exception is also too limited. Indeed, this point needs further examination which can be found below.[45]

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[41] See Peter Kincaid, 'Privity Reform in England' (2000) 116 *LQR* 43, 46.

[42] The severe application of the doctrine of privity was criticized by Steyn LJ in the decision of the Court of Appeal in *Darlington Borough Council v. Wiltshier Northern Ltd.* [1995] 1 WLR 68. In this case, Steyn LJ said, at p.76, that "[t]he case for recognising a contract for the benefit of the third party is simple and straightforward. The autonomy of the will of the parties should be respected. The law of contract should give effect to the reasonable expectations of contracting parties. Principle certainly requires that a burden should not be imposed on a third party without his consent. But there is no doctrinal, logical or policy reason why the law should deny effectiveness to a contract for the benefit of a third party where that is the expressed intention of the parties. Moreover, often the parties, and particularly third parties, organise their affairs on the faith of the contract. They rely on the contract. It is therefore unjust to deny effectiveness to such a contract. I will not struggle with the point further since nobody seriously asserts the contrary." Cited in Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.1.1.

[43] Infra, p.262-7.

[44] Infra, p.262.

Section 1 of the 1999 Act states:

> (1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if-
>
> (a) the contract expressly provides that he may, or
>
> (b) ... the term purports to confer a benefit on him.
>
> (2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.
>
> (3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.

As the 1999 Act came to deal with cases where the third party cannot sue due to the lack of privity, its effect may be limited in cases where the third party has an action. Therefore, in cases of resale of goods, the sub-buyer may bring a suit against the promisee, i.e. the buyer. Therefore, the application of the 1999 Act is very limited. However, the Law Commission Report, *Privity of Contract: Contracts for the Benefit of Third Parties*,[46] provides that "third party consumers stand to gain from our proposals. For example, under our proposals a manufacturer and retailer could expressly confer legal rights on the purchaser to enforce the contracts as regards the quality of the goods purchased, thereby affording a purchaser a remedy if the retailer became insolvent."[47]

However, a close look at Section 1 of the 1999 Act makes it clear that the 1999 Act is unlikely to apply to cases of resale. It is true that Subsection 1(1-b) of the 1999 Act applies where the sale contract confers a benefit on the sub-buyer, such as the case where the seller is aware that the goods are bought in order to perform subcontracts. However, Subsection 1(2) of the 1999 Act may not make it possible for the sub-buyer to bring a direct action against the *original* seller. This is due to the fact that the sub-buyer may bring an action against his immediate seller, i.e. the original buyer. Therefore, the construction of the sale contract shows that the parties to the contract do not intend to confer legal rights on the sub-buyer. However, the parties may *expressly* state in the contract that the sub-buyer has a legal right to enforce the contract. Here, the sub-buyer may rely on Subsection 1(1-a) of the 1999 Act to enforce the contract. The point is well explained in the Law Commission Report itself. The Report provides

> "Without such an express term [a term which expressly confers a legal right on the purchaser], the purchaser would normally have no such right [the right to sue

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[45] Infra, p.259.
[46] Law Com. No.242.
[47] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242.

> the manufacturer] because even if expressly identified as a beneficiary of the manufacturer's contract with the retailer, *the chain of contracts giving the purchaser a remedy against the retailer for the manufacturer's breach means that on a proper construction of the contract, construed in the light of the surrounding circumstances, the manufacturer and retailer do not intend to confer a legal right of enforceability on the third party*."[48] [Emphasis added].

In view of the above discussion, one may state that the 1999 Act allows the sub-buyer to recover damages[49] from the original seller only where there is an express term which provides that sub-buyer has such a right. Such an express agreement is not common. Probably, this is due to the fact that a term to the contract, which indicates that a third party has the right to enforce the contract, was not enforceable until the 1999 Act came into force.

Nevertheless, Subsection 1(1-b) may provide help in cases where the buyer purchases the goods for a third party beneficiary who does not have a cause of action. As will be discussed below,[50] if the buyer informs the seller that the goods will be given to a third party as a gift and asks him to deliver the goods to the third party who is identified by name, the 1999 Act may apply to allow the third party's action against the seller for defective goods. The Law Commission Report, mentioned above, provides a clear example on this point. The example is

> "On Mr and Mrs C's marriage, their wealthy relative B buys an expensive 3 piece suite as a wedding gift from A Ltd, a well known Central London department store with a reputation for quality. She makes it clear when purchasing the 3 piece suite that it is a gift for friends and indeed the delivery slip and instructions show that it is to be sent to Mr and Mrs C's home and should be left with the house keeper as it is a gift. After 2 weeks of wear the fabric on the suite wears thin and frays, and after 3 weeks, two castors collapse. Subject to the rebuttal by A Ltd under the proviso to the second limb [currently Subsection 1(2) of the 1999 Act], Mr and Mrs C can sue A Ltd for breach of an implied term in the contract that the goods be of a satisfactory quality. A Ltd have promised to confer a benefit (the suite of satisfactory quality) on Mr and Mrs C, who have been expressly identified by name."[51] [Footnotes omitted].

The Law Commission Report adds that the third party may not be able to sue the seller if the seller was unaware at the time of making the contract that the goods were

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[48] Ibid, para.7.54, n.44.
[49] Section 1(5) of the 1999 Act states "For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract...".
[50] This is a case of horizontal privity which is discussed at p.259.

purchased for a third party.[52] The requirement of *express* identification of the third party beneficiary may lead to unfair results. As discussed below, the circumstances of the case may indicate that the goods are purchased for a third party beneficiary. In such a case, it will be argued that the third party beneficiary should be entitled to sue the seller for defective goods.[53] In any case, the seller can argue under Subsection 1(2) of the 1999 Act that on the proper construction of the contract, he did not intend to confer a legal right on the third party.

It can be stated that the sub-buyer is unlikely to be able to bring a contract action under the 1999 Act against the *original* seller for defective goods. However, if the 1999 Act ever applies to sale of goods cases, such as the case where there is an express term conferring a legal right on the sub-buyer, the seller can defend the action of the sub-buyer by the same defences that are available to him against the buyer. In general, where a third party brings an action under the 1999 Act, Section 3 of the Act allows the promisor to defend such an action by raising the same defences that he would have if such an action were brought by the promisee.[54] Therefore, the original seller may raise the normal defences in case of a claim for damages, i.e. causation, remoteness, mitigation and certainty. Also, the seller may raise any defence that can be available to him under an express term in the contract.

To sum up, the 1999 Act seems to be concerned with the intention of the contracting parties to confer a legal right on a third party. Obviously, under the 1999 Act, the mere contemplation of the parties that a benefit will be conferred on a third party is not enough for the third party to enforce the contract. However, as discussed below,[55] the

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[51] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, example 14, para.7.41.
[52] Ibid, example 15, para.7.42.
[53] Infra, p.260.
[54] Subsections 3(2) of the 1999 Act states "The promisor shall have available to him by way of defence or set-off any matter that- (a) arises from or in connection with the contract and is relevant to the term, and (b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee."
Subsection 3(3) states "The promisor shall also have available to him by way of defence or set-off any matter if- (a) an express term of the contract provides for it to be available to him in proceedings brought by the third party, and (b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.
Subsection 3(4) states "The promisor shall also have available to him- by way of defence or set-off any matter, and (b) by way of counterclaim any matter not arising from the contract, that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract."
[55] Infra, p.221.

ultimate buyer *should* be allowed to sue the original seller for defective goods in cases where the original seller was aware at the time of making the contract that the goods will be resold. This argument will be based on the fact that in chain contracts liability may pass up the chain until it reaches eventually the original seller. Therefore, the ultimate buyer should be allowed to sue the original seller directly in order to bring the law into line of reality. However, the question is whether the court can go beyond the 1999 Act to allow the ultimate buyer to sue the manufacturer even though the agreement between the manufacturer and his immediate buyer does not *expressly* confer such a right on the ultimate buyer. In principle, this question can be answered in the positive since the Law Commission Report, on which the 1999 Act is based, makes it clear that where the court decides that the 1999 Act does not go far enough, it may offer the third party more protection than that he receives under the 1999 Act. The Law Commission Report states

> "[w]e should emphasise that we do not wish our proposed legislation - which we believe to be a relatively conservative and moderate measure - to hamper the judicial development of third party rights. Should the House of Lords decide that *in a particular sphere our reform does not go far enough and that, for example, a measure of imposed consumer protection is required..., we would not wish our proposed legislation to be construed as hampering that development.*"[56] [Emphasis added].

However, the court is unlikely to go beyond the boundary of the 1999 Act in normal cases since by doing so, the court will ignore the 1999 Act. The court may go beyond the 1999 Act only in cases which require policy consideration. There seems to be a room to argue that there should be special treatment for certain cases of consumer sale. It is true that the Law Commission has rejected the tests which automatically give consumers the right to sue the original seller and preferred to apply the "dual intention"[57] test to all cases.[58] However, the Law Commission avoided proposing any special test of enforceability for consumers in order to avoid any conflict with other law reforms, such

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[56] The Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.5.10.

[57] Under the "dual intention" test, a third party may enforce a contract in which the parties intend that he should receive the benefit of the promised performance and also intend to create a legal obligation enforceable by him.

[58] These tests are 1) a third party may enforce a contract on which he justifiably and reasonably relies, regardless of the intentions of the parties; 2) a third party may enforce a contract which actually confers a benefit on him, regardless of the purpose of the contract or the intention of the parties. See Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, paras.7.53, 7.54.

as the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees.[59] The Law Commission Report states

> "[w]e consider that the automatic conferring of contractual rights on third parties who are consumers rests on policy considerations that need to be tackled in relation to specific areas. We do not think that they can properly be addressed through the kind of general reform with which we are here concerned. Indeed we think that it would be dangerous - in terms of producing a potential conflict of reform proposals - for us here to embark on specific measures of consumer protection when there are other reform initiatives under discussion in specific areas, based on protecting consumers. We have in mind particularly consumer guarantees.... Rather our strategy is to reform the general law of contract, based on effecting contracting parties' intentions, which then leaves the way free for more radical consumer protection measures in future in specific areas."[60] [Footnotes omitted].

It is clear from this statement that the Law Commission did not provide a special test of enforceability of contract by consumers since their proposal was based on effecting the contracting parties' intention in the general law of contract. However, the Law Commission did not reject the idea that there should be special treatment for consumer cases and left the way free for more consumer protection measures. Such protection measures can be made by legislation. It will be seen that the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees will be reviewed in relation to producer's liability. However, any provision for producer's liability under the Directive is unlikely to give the consumer the right to claim damages. The Directive's remedial scheme, as explained below, does not make the remedy of damages available for consumers. Meanwhile, one may also argue that the court still has the discretion to go beyond the boundary of the 1999 Act in order to offer consumers more protection in certain cases. This argument is based on the ground that the aforementioned statement of the Law Commission indicates that the 1999 Act provides a minimum protection for consumers and leaves the way free for further protection. As submitted in the next section, the court, at least in cases where the consumer cannot sue his immediate seller since the latter has disappeared or become insolvent, should allow such a consumer to bring a contract action against the original seller regardless of whether or not the 1999

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[59] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, Official Journal L 171 , 07/07/1999.
[60] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.7.55.

Act allows such an action.[61] The next section argues that the 1999 Act does not go far enough to protect the ultimate buyer in cases of 'string contracts'.

One of the difficulties that faced the Law Commission in proposing the 1999 Act is the requirement of consideration. Although it seems inadequate for the purpose of this research to deal with the issue of whether the requirement of consideration is in need for reform, it is worth mentioning that the Law Commission has pointed out that the maxim "consideration must move from the promisee" might be interpreted to disallow the third party beneficiary who did not provide the consideration to enforce the contract.[62] In other words, the maxim might be interpreted to require the consideration to move from the plaintiff.[63] In fact, the 1999 Act does not consider the third party as a party to the contract. It merely confers the right to enforce the contract on him. Therefore, the rule that consideration must move from the promisee should not affect the right of the third party to sue under the contract.[64] In this sense, as long as the promisee provides a consideration, the third party beneficiary need not provide a consideration in order to have the right to sue under the contract. To avoid any confusion, the Law Commission has recommended that the law should ensure that the maxim mentioned should not be interpreted to disallow the third party to enforce the contract.[65] The Law Commission Report indicates that giving the third party beneficiary a statutory right to enforce the contract should imply a reform of the rule that consideration must move from the promisee where such a rule means that consideration must move from the plaintiff.[66]

At the last point of this section, one should not fail to mention that the ultimate buyer may have an action against the original seller by several means. For example, where the ultimate buyer suffers physical loss, he may sue in tort. Moreover, where the buyer assigns the benefit of the contract to the sub-buyer, the sub-buyer may have a cause of

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[61] This submission presumes that the seller is reasonably aware at the time of making the contract that the goods will be resold.

[62] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.6.5.

[63] See John Adams, Deryck Beyleveld and Roger Brownsword, "Privity of Contract — the Benefits and the Burdens of Law Reform" (1997) 60 *MLR* 238, 247.

[64] See Hugh Beale, "Privity of Contract: Judicial and Legislative Reform" (1995) 9 *JCL* 103, 113; John Adams and Roger Brownsword, "Privity and the Concept of a Network Contract" (1990) 10 *L.S.* 12, 22.

[65] Recommendation 6 of the Law Commission states that "the legislation should ensure that the rule that consideration must move from the promisee is reformed to the extent necessary to avoid nullifying our proposed reform of the doctrine of privity." Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242.

action against the original seller.[67] Such an assignment is also possible under the American Law. For example, in *Dravo Equipment Co. v. German*[68] it was stated that express warranty can be transferred to the transferee, e.g. sub-buyer, of the goods unless the warranty indicates otherwise.[69] As a result, the sub-buyer can sue the warrantor for breach of such express warranty as long as his use of the goods is not substantially different from the buyer's use.[70] Here, it should be noted that the seller may prohibit such assignment by an express term of the contract. In cases of express warranties, it is common that such a warranty provides that it is available for the first purchaser and for specific period of time after the date of purchase.

Furthermore, the sub-buyer may have a cause of action against the original seller under an express warranty issued by such a seller to the ultimate buyer. The issue of whether such a warranty is enforceable is the subject matter of the next section. Here, it should be clear that this work is not concerned with warranties purchased by the buyer. The ultimate buyer may pay extra sum of money to obtain the remote seller's warranty. In such cases, the retailer, most likely, acts as an agent for the remote seller since the price of such a warranty goes to the remote seller. Hence, under this warranty, the ultimate buyer would be in a direct contractual relationship with the remote seller. However, such a practice is uncommon. The buyer may pay extra money to insure the goods purchased.[71] The insurer may be the retailer or an insurance company to which the retailer acts as an agent.

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[66] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.6.8, n.8.

[67] See *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.* [1994] 1 AC 85. See also *Darlington Borough Council v. Wiltshier Northern Ltd.* [1995] 3 All ER 895; P.S. Atiyah, *The Sale of Goods,* Pitman Publishing, 9th ed., 1995, p.231.

[68] 73 Or. App. 165; 40 UCC Rep. Serv. 1240 (1985). See also C*ollins Co. v. Carboline Co.* N.E.2d 834 (1988), where the Illinois Supreme Court held that an assignee of an express warranty *aquires privity* of contract with the warrantor.

[69] Section 2-210(2) of the UCC provides that "Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise."

[70] See TD Crandall, MJ Herbert and L. Lawrence, *Uniform Commercial Code,* Boston, 1993, p.7.73. See also S. Bonanno, 'Privity, Products Liability, and UCC Warranties: a Retrospect of and Prospects for Illinois Commercial Code §2-318' (1991) 25 *J. Marshall L. Rev.* 177, 197.

[71] M.P. Furmston, 'Defective Goods and Exclusion Clauses' in *Buying and Selling law*, Croner Publication Ltd., p.3.52. The ultimate buyer may also insure the goods purchased through the retailer who acts as an agent for the insurance company.

6.1.2 The Privity Requirement should be Relaxed in 'String Contracts'

The previous section hopefully made it clear that the 1999 Act does not provide much help in cases of string contracts. The law as it stands *at present* does not seem to provide sufficient protection to the ultimate buyer nor does it prevent the manufacturer escaping liability for purely economic losses resulting from the defective quality of his products. The manufacturer, who knows that he will not be directly liable to the ultimate buyer for defective products, may have no adequate incentive to produce his goods carefully. Liability may not pass up the chain in all cases, as explained below. Therefore, Adams and Brownsword argue that "if end purchasers do not normally have any option other than to sue the immediate contracting party in the chain, we might wish to relax the privity restriction where it is not possible to work liability back along the chain. In such circumstances, it is arguable that the purchaser should be permitted to leapfrog over the first defendant."[72] The ultimate buyer legitimately expects the manufacturer to produce goods of the right quality. The manufacturer should know that the ultimate buyer will have such a legitimate expectation. Therefore, the manufacturer, as Adams and Brownsword suggest,[73] should be liable for the defective quality of goods. Chris Willett seems to have similar view. He argues that the "doctrinal obstacles to recovery for poor quality goods from the manufacturer flout what are perfectly reasonable consumer expectations. Most consumers probably reasonably imagine that manufacturers (who actually make the goods) should be primarily responsible if the goods are qualitatively defective. These expectations may be particularly important in circumstances where the retailer cannot be sued because he is untraceable or insolvent."[74]

Professor Beale argues that the extent of manufacturer's liability may be uncertain because he does not have adequate information about the buyer's or end-user's losses. Therefore, "it may be cheaper for the buyer or end-user to bear the uncertain losses itself, since it will have better information and can therefore insure more cheaply".[75] Obviously, Professor Beale bases his arguments on the costs and, as a result, on the price of the goods. However, he argues that the manufacturer should have an adequate incentive to produce his goods carefully. Thereupon, he suggests that the manufacturer should be liable for the cost of repairing or replacing the goods or refunding the price;

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[72] John Adams and Roger Brownsword, *Key Issues in Contract,* London, 1995, p.152.
[73] Ibid, p.156.
[74] Chris Willett, "The Quality of Goods and the Rights of Consumers" (1993) 44 *NILQ* 218, 225.

but the manufacturer should not be liable for consequential losses suffered by the ultimate buyer or end-user.[76] As regards price refund one may ask which price that the ultimate buyer should recover. Is it the retail price or the price that the manufacturer received from his immediate buyer? It can be argued that the ultimate buyer should receive what he has paid for the goods, i.e. the retail price. But this may not be fair in cases where the retail price is more than the market or reasonable price. Therefore, the consumer should not be entitled to recover from the manufacturer the unreasonable price he paid to the retailer.

Professor Beale does not ignore the liability of the manufacturer for consumer's economic consequential losses. He argues that consumers should be entitled to recover the cost of hiring a replacement while the defective goods are being repaired or replaced. This may, as he suggests, "give the manufacturer an adequate incentive to get on and repair or replace."[77] The consumer's usual consequential economic loss is the cost of hiring replacement while the goods are being repaired or replaced. If the defective goods cause physical damage, the consumer may be able to bring an action against the manufacturer under the Consumer Protection Act 1987. By this way, the consumer can be totally compensated. However, where the goods are bought to be used in business, the consequential economic loss is normally loss of profit. Professor Beale argues that the manufacturer should not be directly liable for such a loss as the cost of bearing such a loss will be high.

However, the manufacturer still needs to insure for his liability against his immediate buyer. If the extent of the manufacturer's liability to the ultimate buyer is uncertain since he does not have adequate information about such a buyer, the extent of his liability to his immediate buyer may become uncertain. This is due to that fact that retailer's liability for the ultimate buyer may pass up the chain until it reaches the manufacturer. In this sense, the manufacturer will bear the loss of the ultimate buyer whether through his liability to his immediate buyer or through his liability to the ultimate buyer. In other words, the manufacturer's extent of liability may be uncertain whether against his immediate buyer or the ultimate buyer. Professor Beale justifies his opinion on the

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[75] Hugh Beale, "Customers, Chains and Networks" in Chris Willett, *Aspects of Fairness in Contract,* 1996, 137, 146.
[76] Ibid, p.146.
[77] Ibid, pp.146-7.

ground that manufacturers normally limit their liability down the chain of contracts. He argues that such a practice is "an efficient arrangement knowingly agreed to by the parties because of the cost of requiring the manufacturer to bear liability which is uncertain in extent."[78] In order to leave an incentive for the manufacturer to produce his goods carefully, Professor Beale suggests that the manufacturer, as against the ultimate buyer's claim, should not be allowed to rely on exclusion clauses included in the contract he made with his immediate buyer. However, he suggests that the manufacturer should be allowed to rely on such exclusion clauses where the ultimate buyer agreed on similar clauses in his contract with the retailer or where the ultimate buyer consented to such clauses.[79]

I do believe that the view of Professor Beale is quite appropriate in cases where all the contracts in a distribution chain include similar exclusion clauses. However, this is not always the case. There may be cases where the manufacturer does not exclude his liability to his immediate buyer and one of the parties to the distribution chain has disappeared or shelters behind exclusion clauses. In such cases, the liability for the ultimate buyer's consequential loss will not reach the manufacturer as the distribution chain is broken. Therefore, the manufacturer will escape liability. Furthermore, liability will not reach the manufacturer if the retailer has disappeared or become insolvent. Therefore, it is submitted that the manufacturer should be liable for all losses suffered by the ultimate buyer. If the loss results from unusual use of the goods, the manufacturer will not be liable unless he guaranteed the goods to be fit for such an unusual use. In addition, the remoteness principle should protect the manufacturer against the ultimate buyer's claim for abnormal losses which he could not reasonably have contemplated at the time he sold the goods to his immediate buyer. In general, as between 'network contracts',[80] Adam and Brownsword suggest that the requirement of privity doctrine

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[78] Ibid, pp.145.
[79] Ibid, pp.150.
[80] John Adams and Roger Brownsword, supra n.64 at pp.27-8. They reach their conclusion in the light of the exceptions to the privity restriction under the common law. They define a network contract as follows: "1. A network contract is a contract forming part of a set of contracts. 2. The set of contracts has the following characteristics: (i) there is a principal contract (or, there are a number of principal contracts) within the set giving the set an overall objective; (ii) other contracts (secondary and tertiary contracts, and so on) are entered into, an object of each of which is -directly or indirectly- to further the attainment of this overall objective; and, (iii) the network of contractors expands until a sufficiency of contractors are obligated, whether to the parties to the principal contract or to other contractors within the set, to attain the overall objective."

should have no application. This should apply similarly in cases of chain contracts.[81] They state that "whereas, at present, the privity doctrine operates in relation to strangers to *particular* contracts (irrespective of whether such contracts comprise a network), we propose that privity should operate in relation only to strangers to a particular *network* of contracts (but not as between the network contractors themselves)."[82] However, as previously discussed, the court may not go farther than the Contracts (Rights of Third Parties) Act 1999 in cases of normal circumstances. Nevertheless, it is submitted that there should be special treatment to cases of chain contracts. If this general submission is not accepted, I propose that the court should pay special attention to cases where the retailer disappears and the ultimate buyer is left without remedy. In such cases, the ultimate buyer should be allowed to bring a direct contract action against the manufacturer. As previously discussed, the 1999 Act offers the third party a minimum protection and leaves the way free for further protection if the court decides that the Act does not go far enough.[83]

In order to bring about justice under this submission, the manufacturer should be entitled to rely on the exclusion clauses included in his contract with his immediate buyer. In fact, the manufacturer may bear the loss suffered by the ultimate buyer by paying damages to his immediate buyer for the latter's liability to the ultimate buyer who suffered losses caused by the defective goods. As the manufacturer can rely on the exclusion or limitation clauses against his immediate buyer's claim for the latter's liability to the ultimate buyer, he should be entitled to rely on such clauses as against the direct claim of the ultimate buyer. Adams and Brownsword, after submitting that the doctrine of privity should be relaxed in cases of network contracts, argue that a party to the contract should be able to rely on the terms of the contract to defend the third party's action.[84] It is submitted that the manufacturer should be able to rely on the terms of his contract with the immediate buyer in order to defend the ultimate buyer's action.

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[81] In John Adams and Roger Brownsword, *Key Issues in Contract*, London, 1995, p.152, the authors argue that chain of contracts "should be treated as if it were a network. For example, if a dealer is a recognised outlet for a particular manufacturer's products (say, the manufacturer's motor cars, or electrical goods), with the goods being supplied to the dealer through a distribution system controlled by the manufacturer, then it is artificial to treate the chain as so many discreate contracts. Moreover, it is arguable that consumer purchasers should be regarded as being in direct contract with any contractors in the chain."
[82] John Adams and Roger Brownsword, supra n.64 at p.13.
[83] Supra, p.217.
[84] John N. Adams and Roger Brownsword, supra n.64 at p.27.

Therefore, the seller may take measures of defence against the claim of the sub-buyer.[85] As it is the case under Subsection 3(6) of the 1999 Act, the parties need not indicate expressly that an exclusion term applies to the sub-buyer's action.[86] In fact, this was stated in one case where the ultimate buyer brought an action in tort against the manufacturer. In *Muirhead v. Industrial Tank Specialities Ltd. and Others*,[87] where the ultimate buyer sued the manufacturer in tort, Robert Goff LJ made it clear that the manufacturer, as against the ultimate buyer, can rely on the terms of his contract with his immediate buyer.[88]

However, two points should be added to this submission. Firstly, in consumer claims, the manufacturer should not be able to exclude his liability for breach of any of the implied terms 13, 14 and 15 of the SGA. The rules of the Unfair Contract Terms Act 1977 regarding consumer claims *should* apply in order to disallow excluding liability for breach of the implied terms of description and quality provided by the SGA.[89] Secondly, the exclusion of liability clauses should be communicated to the ultimate buyer by attaching them to the goods or by other appropriate means in order to give such a buyer an opportunity to take pre-caution measures, such as insurance.

In February 1992, the Department of Trade and Industry proposed for a statutory reform concerning the manufacturer's liability for defective goods. The proposal contained three sections:

> (1) The manufacturer should be civilly liable under statute for the performance of his guarantee to the consumer. In cases where the manufacturer is outside the UK, the manufacturer's guarantee would be enforceable against the importer.
> (2) The retailer should be jointly and severally liable with the manufacturer for the manufacturer's guarantee to a consumer.

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[85] See W.K. Jones, 'Product Defects Causing Commercial Loss: The Ascendancy of Contract over Tort' (1990) 44 *U. Miami. L. Rev.* 731, 791.

[86] Subsection 3(6) of the 1999 Act provides "Where in any proceedings brought against him a third party seeks in reliance on section 1 to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he may not do so if he could not have done so (whether by reason of any particular circumstances relating to him or otherwise) had he been a party to the contract." See Meryll Dean, 'Removing a Blot on the Landscape—The Reform of the Doctrine of Privity' [2000] *JBL* 143, 151.

[87] [1986] 1 QB 507.

[88] *Muirhead v. Industrial Tank Specialities Ltd. and Others,* [1986] 1 QB 507, 529.

[89] The application of Section 3 (Liability arising in contract) of the Unfair Contract Terms Act 1977 seems to be limited to the claims of the contracting parties. Section 3(1) states that "This section applies as between *contracting parties* where one of them deals as consumer or on the other's written standard terms of business". [Emphasis added]. Section 6(2) of the Unfair Contract Terms Act 1977 states "As against a person dealing as consumer, liability for breach of the obligations arising from— (a) [section 13, 14 or 15 of the [1979] Act] (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality of fitness for a particular purpose)... cannot be excluded or restricted by reference to any contract term."

(3) Manufacturers or, in the case of imported goods, importers, should be liable with the seller for the satisfactory quality of goods under the Sale of Goods Act 1979.

Under the first section of the proposal, there seems to be no need to discuss whether the manufacturer's warranty, issued to the consumer, can furnish a legal ground for a collateral contractual relationship. However, the section does not provide the kind of remedy that the consumer can claim. Section two of the proposal may create some practical difficulties. The main problem is that retailers will not be able to participate in drafting manufacturer's express warranties and, in most cases, they may not be aware of the content of those warranties which are packaged with or accompanying the goods.[90] In addition, the retailer may not be able to perform the manufacturer's guarantee. For example, suppose that the guarantee is for repair. The retailer may not have the facilities that may enable him to repair the goods. The producer's guarantees of repair, replacement and refund of price will become legally binding after the implementation of the EC Directive, as discussed under the next section. The producer will not be liable to the consumer for giving false statements regarding the quality of goods. However, under the Directive, such statements are considered in assessing the retailer's liability to the consumer. Under the next section, it will be argued that the Directive should be reviewed in a way to make the producer liable for his false statements instead of the retailer.

The DTI proposal is concerned with guarantees issued by manufacturers or importers only. So, what would be the case if a wholesaler or a distributor, other than the importer, issued a warranty to the ultimate buyer? In addition, the proposal does not deal with the issue where the goods are expected to be used by beneficiaries other than the ultimate buyer.[91] Furthermore, the proposal does not deal with the case where the ultimate buyer is a non-consumer. In fact, non-consumer buyers are more likely to suffer economic losses than consumers. Since such economic losses cannot be claimed in tort, a statutory reform is needed to allow them to sue the remote seller in contract.

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[90] G.G. Howells and S. Weatherill, *Consumer Protection Law*, 1995, 163. In cases of manufacturer's guarantee which contains a promise for repair, the retailer may find it difficult to perform such guarantee.
[91] Chris Willett, "The Quality of Goods and the Rights of Consumers" (1993) 44 *NILQ* 218, 226.

6.1.3 Remote Seller's Liability under the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees

The purpose of the EC Directive[92] is to provide a minimum protection for consumers. In other words, it is intended to be a minimum harmonisation of the measures of consumer protection among the Member States.[93] Although the provisions of the Directive are, to some extent, similar to the relevant provisions of the SGA, its remedial scheme for defective goods is different. The remedy of damages, as the primary remedy under English law, is not available under the Directive. The Directive provides four remedies for defective goods, i.e. repair, replacement, price reduction and recission. However, the buyer does not have the choice of remedy under the Directive. Article 3(3) of the Directive states: "In the first place, the consumer may require the seller to repair the goods or he may require the seller to replace them, in either case free of charge, unless this is impossible or disproportionate."

The question here is whether the remedy of damages will be available in consumer cases after the implementation of the Directive. Twigg-Flesner and Bradgate argue that under existing domestic law consumers can be better protected than under the Directive.[94] Indeed, under English law the consumer can reject defective goods, even though the defect is minor,[95] and repudiate the contract.[96] In such a case, the buyer may recover the

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[92] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, Official Journal L 171 , 07/07/1999.

[93] Article 1(1) of the Directive states "The purpose of this Directive is the approximation of the laws, regulations and administrative provisions of the Member States on certain aspects of the sale of consumer goods and associated guarantees in order to ensure a uniform minimum level of consumer protection in the context of the internal market."

[94] Christian Twigg-Flesner and Robert Bradgate, 'The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees-All Talks and No Do?' [2000] *Web JCLI* <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html> section 6(c).

[95] Section 15A of the SGA does not allow the buyer to reject the goods for minor defects unless the buyer deals as a consumer.

[96] Implied terms provided by Sections 13, 14 and 15 of the SGA are conditions. Section 11(3) of the SGA allows the buyer to reject the goods *and* repudiate the contract if the seller is in breach of a condition. The Section states "Whether a stipulation in a contract of sale is a condition, the breach of which may give rise to a right to treat the contract as repudiated, or a warranty, the breach of which may give rise to a claim for damages but not to a right to reject the goods and treate the contract as repudiated, depends in each case on the construction of the contract..." Obviously, the wording of Section 11(3) of the SGA makes it clear that the buyer has two separate rights in cases of breach of condition, i.e. to reject the goods and to repudiate the contract. See Bradgate, R and White, F, "Rejection and Termination in Contracts for the Sale of Goods" in J. Birds, R. Bradgate and C. Villiers (eds.) *Termination of Contracts,* London, 1995, 53, 68. Bradgate and White convincingly argue against the view that the seller may have the right to remedy his defective performance if he can deliver substitute goods within the delivery period and his initial breach is not repudiatory. In fact, such a view seems to be in contradiction with Section 11(3) of the SGA since such a Section provides for the buyer's right to terminate the contract if the seller is in breach of a condition. Therefore, it is the buyer's choice to allow the seller to remedy his breach and the seller cannot impose specific performance, i.e. replacement, upon the buyer. Where the seller delivers defective

contract price by a restitutionary action.[97] He may also claim damages under Sections 51 and 54 of the SGA. Furthermore, the consumer may choose to accept the defective goods and claim damages for breach of warranty of quality. In this case, their damages can be quantified as discussed in this research. Under the Directive, the consumer does not have such a choice. The remedy of specific performance, i.e. repair or replacement, is imposed upon him. He will not be able to rescind the contract unless repair or replacement is impossible or disproportionate.[98] Moreover, rescission is not available under the Directive where the defects in the goods are minor.[99] Thereupon, Twigg-Flesner and Bradgate suggest that the Directive should be implemented by free standing regulations operating in parallel with the SGA.[100] If this becomes the case, the consumer may be able to rely on the Directive or the SGA as the case may be. It can be noted here that consumers may prefer repair of defective goods. The SGA does not offer the consumer a legal right to ask for repair or replacement. This can be understandable in the light of the restrictive approach of English law to grant specific performance. In view of that, the implementation of the Directive is necessary as it provides that the consumer has the right to demand repair or replacement of non-conforming goods.

In certain cases, repair and replacement may be impossible. This can be the case where the buyer purchases goods in order to be mixed them with other ingredients. If the goods are defective, the ingredients can be spoilt. As repair and replacement are impossible in such a case, the buyer will be entitled to price reduction. The buyer's loss will not be considered for the purpose of quantifying price reduction, as explained in chapter three.[101] Therefore, the remedy of damages will be important in such a case in order to allow the buyer to bring a contract action against the seller for the losses caused by the

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goods, the buyer may reject the goods and ask for replacement. In such a case, the buyer rejects the goods but does not treat the contract as repudiated. If the seller does not deliver substitute goods, the buyer may repudiate the contract and claim damages for non-delivery under Section 51 of the SGA. Nevertheless, such a debate may not affect consumer cases where there is no period of delivery. In most consumer contracts, the goods are delivered at the time of making the contract.

[97] See Section 54 of the SGA.

[98] Article 3(3) of the Directive states ".... A remedy shall be deemed to be disproportionate if it imposes costs on the seller which, in comparison with the alternative remedy, are unreasonable, taking into account:
- the value the goods would have if there were no lack of conformity,
- the significance of the lack of conformity, and
- whether the alternative remedy could be completed without significant inconvenience to the consumer."

[99] Article 3(6) of the Directive states "The consumer is not entitled to have the contract rescinded if the lack of conformity is minor."

[100] Christian Twigg-Flesner and Robert Bradgate, 'The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees-All Talks and No Do?' [2000] *Web JCLI* <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html> section 7.

defective goods. Price reduction will not compensate the buyer for his actual loss. This is one of the cases where the remedial scheme under the SGA can be more favourable for the consumer than the Directive's remedial scheme. Indeed, implementing the Directive by free standing regulations operating in parallel with the SGA will offer the consumer the choice to bring a claim under the SGA or the Directive, which means better consumer protection.

The CISG provides the same remedies that are available to the buyer under the Directive. However, under the CISG, the buyer has the choice of remedy. If the buyer is entitled to price reduction under the CISG, he may also claim damages for consequential losses as explained in chapter three.[102] The Directive does not adopt the same remedial scheme. Therefore, in the aforementioned example of goods purchased in order to be mixed with other ingredients, if the buyer claimed price reduction under the CISG, he would be able to claim damages for the wasted ingredients. However, this is not the case under the Directive. Even where the buyer does not suffer consequential losses, the remedy of damages may be more favourable to him in certain cases, as discussed in chapter three. As Shears, Zollers and Hurd suggest, the remedies under the Directive are designed for disappointment and not for the buyer's injury.[103] Therefore, it is significant to keep the remedial scheme of the SGA available to consumers after the implementation of the Directive.

The main question, for the purpose of the argument in this chapter, is whether the ultimate buyer can sue the remote seller (producer)[104] for defective goods. Under the *current* text of the Directive, the answer is in the negative. However, the producers' statements regarding the quality of goods may be taken into account in determining whether or not the goods are defective. In other words, the retailer may be held liable for breach of the manufacturer's public statement regarding the quality of the goods. Article 2(2) of the Directive states

> "Consumer goods are presumed to be in conformity with the contract if they... show the quality and performance which are normal in goods of the same type

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[101] Supra, p.107.
[102] Supra, p.111.
[103] Peter Shears, Frances E. Zollers and Sandra N. Hurd, "It will be the biggest change to consumer rights for 20 years!" [2000] JBL 262, 276.
[104] Article 1 (2-c) of the 1999 EC Directive defines producer as "the manufacturer of the consumer goods, the importer of consumer goods into the territory of the Community or any person purporting to be a producer by placing his name, trade mark or other distinctive sign on the consumer goods".

> and which the consumer can reasonably expect, given the nature of the goods and *taking into account any public statements on the specific characteristics of the goods made about them by the seller, the producer or his representative, particularly in advertising or on labelling*." [Emphasis added].

In fact, it seems strange to hold the retailer bound by public statement issued by the manufacturer who is not directly bound by it. This may be extremely unfair in cases where the retailer becomes aware of the statement after he purchases the goods from a seller in a distribution chain. One here may suggest that the retailer may sue the distributor for his liability to the consumer; the distributor may pass the liability up the chain until it reaches the manufacturer. However, where the consumer's claim is for breach of manufacturer's statement, the distributor will not be liable for the consequences of such a breach. Consequently, the retailer will not be able to recover damages from the distributor for his liability to the consumer which was caused by the manufacturer's breach of his public statement. As a result, under this regime, where the retailer did not purchase the goods directly from the manufacturer, the manufacturer will escape liability for giving wrong statement about the quality of goods.[105] Although this regime may offer better protection for consumer, it seems to be unfair for the retailer.

More importantly, the consumer may not benefit from the retailer's liability in cases where the retailer has disappeared or become insolvent. Furthermore, the retailer may not be bound by public statements in certain cases. Article 2(4) of the Directive states

> "The seller shall not be bound by public statements, as referred to in paragraph 2(d) if he:
> - shows that he was not, and could not reasonably have been, aware of the statement in question,
> - shows that by the time of conclusion of the contract the statement had been corrected, or
> - shows that the decision to buy the consumer goods could not have been influenced by the statement."

In view of the above discussion, it can be noted that the producer should be liable for breach of his public statement. Furthermore, the producer should be directly liable to the consumer for defective goods. This may not create any contradiction with the 1999 Act since the Law Commission Report, on which the 1999 Act is based, makes it clear that the 1999 Act is not intended to prevent any further protection for consumers.[106] In fact,

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[105] Hugh Beale, supra n.75 at p.153.
[106] Supra, p.217.

producer's liability for defective goods may be added to the Directive later. Article 12 of the Directive states expressly that the Directive will be reviewed in relation to, *inter alia,* "the case for introducing the producer's direct liability and, if appropriate, shall be accompanied by proposals." Recital 23 provides that in light of "the experience acquired in implementing this Directive, it may be necessary to envisage more far-reaching harmonization, notably by providing for the producer's direct liability for defects for which he is responsible".

If the review of the Directive produces a new provision for the producer's direct liability, the same remedial scheme of the Directive may apply. Therefore, the remedy of damages will not be available for consumers against the producer. However, this may lead to unfair results where the consumer suffers consequential losses caused by defective goods. In cases where the consumer suffers physical losses resulting from defective goods, he may sue the producer under the Consumer Protection Act 1987. Therefore, the buyer may recover for his actual loss by suing the producer under the Directive and the Consumer Protection Act 1987. However, where the consumer incurs extra expenses due to the defective quality of goods, he will not be able to recover such expenses under the Directive. It is submitted that English law should go farther than the Directive to offer consumers the right to sue the remote seller for all foreseeable losses resulting from defective goods. By this way, the consumer can be better protected. If this submission is ever accepted, double recovery can always be avoided by disallowing the consumer to recover damages from the retailer and the producer for the same loss. As previously argued, the remote seller should be liable to the ultimate buyer, whether commercial or consumer, for foreseeable losses resulting from defective quality. Indeed, a reform regarding remote seller's liability, as Professor Beale suggests,[107] is necessary in both commercial and consumer cases.

At the last point, it should be noted that the Directive makes it clear that certain manufacturer's guarantees are legally enforceable.[108] As discussed below, the enforceability of such guarantees is debatable under English law. Although such guarantees are likely enforceable under English law, the Directive removes any doubt about their enforceability. Article 6 of the Directive states

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[107] Hugh Beale, supra n.75 at p.139.

[108] See Robert Bradgate, 'Harmonisation of Legal Guarantees: A Common Law Perspective' [1995] *Consum. L.J.* 94, 107.

"1. A guarantee shall be legally binding on the offerer under the conditions laid down in the guarantee statement and the associated advertising. 2. The guarantee shall:

- state that the consumer has legal rights under applicable national legislation governing the sale of consumer goods and make clear that those rights are not affected by the guarantee,
- set out in plain intelligible language the contents of the guarantee and the essential particulars necessary for making claims under the guarantee, notably the duration and territorial scope of the guarantee as well as the name and address of the guarantor."

Article 1 of the Directive defines guarantee as "any undertaking by a seller or producer to the consumer, given without extra charge, to reimburse the price paid or to replace, repair or handle consumer goods in any way if they do not meet the specifications set out in the guarantee statement or in the relevant advertising." In view of that, the Directive does not deal with the enforceability of the remote seller's warranty as to the quality of goods. If the remote seller issues a warranty which states that the goods are of specific quality, he will not be held liable under the Directive for breach of false warranty. Whether such a warranty is enforceable under English law is the subject-matter of the next section. Chris Willett suggests that manufacturers tend to honour their guarantees of repair, replacement or reimbursement of the price; therefore, a reform is needed to hold the producer bound by his warranty as to the quality of goods which he issues to the ultimate buyer.[109]

Under Article 6(3) of the Directive, the guarantee should be made available to consumers on their request. This may not be possible in cases of packaged warranties where the consumer may not have access to by the time he purchases the goods.[110] However, under Article 6(5) of the Directive, the fact that the guarantee was not made available to the consumer does not make the guarantee unenforceable.

6.1.4 Passing up the Liability in 'String Contracts'

Where the ultimate buyer suffers a loss for breach of warranty of quality, he may, in the normal course of circumstances, claim damages from his direct seller. In cases of chain contracts if the seller is held liable, he may pass the liability to his seller by claiming the

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[109] Chris Willett, "The Quality of Goods and the Rights of Consumers" (1993) 44 *NILQ* 218, 230.
[110] See Peter Shears, Frances E. Zollers and Sandra N. Hurd, "It will be the biggest change to consumer rights for 20 years!" [2000] JBL 262, 269.

compensation that he paid to the ultimate buyer.[111] By this method, liability may pass on from a seller to another until it reaches eventually the manufacturer. However, this may not be always the case.

6.1.4.1 The Deficiency of the Method

The method of "passing the liability" may be deficient in two cases, i.e., where it increases the remote seller's liability and where the chain of contracts is broken. The remote seller may be considerably more liable through this method than where he is sued directly by the ultimate buyer. It is quite obvious that such a remote seller may be liable for all expenditures incurred reasonably[112] by the sellers in the chain contracts on defending the claims of breach of warranty.[113] One here may suggest that the seller in a distribution chain may bring his direct seller into the case. The latter may also bring his direct seller and so on till the original seller is brought to defend the action.[114] By this way, expenses might be cut down and the original seller's liability would not increase materially. On this point, some time ago, Talman has pointed out that if defendants can be substituted by other defendants in an action for breach of warranty within the vertical distribution chain, why cannot the injured party sue directly the remote seller who is originally liable for the deficiency of the goods in question? He suggested that in such

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[111] See the UCC case of *Mann v. Weyerhaeuser Co.* 703 F.2d 272 (8th Cir. 1983), where the buyer was allowed, as damages, the compensation he paid to his customers due to the manufacturer's breach of warranty of quality.

[112] Regarding expenditures incurred in defending a sub-buyer's claim, such expenditures are recoverable if they were reasonable. Where the original seller was informed of the sub-buyer's claim and he refused to contribute in defending it, the expenditures are likely to be held reasonable. On the other hand, where the buyer defends the sub-buyer's claim after he knew from the seller that there is no defence, the expenditures incurred on such a defence are likely to be unreasonable. See *Hammond & Co. v. Bussey* (1888) 20 QB 79; *Bennet v. Kreeger,* (1925) 41 TLR 609.

[113] See the decision of the Supreme Court of the United States in *Western Seed Production Corp. v. Campbell,* 1969 U.S. LEXIS 2552; 393 U.S. 1093 (1969) Where the buyer settles the sub-buyer's claim out of the court, the amount paid through such a settlement should be reasonable. See also *Kasler and Cohen v. Slavouski* [1928] 1 KB 78 where A sold dyed rabbit skins to B who resold them to C. There was a chain of contracts till the one of the items reached F. F recovered from his directed buyer for the "fur dermatitis" he suffered due to the defective quality of the skins. Each buyer in the chain recovered what he paid to his sub-buyer from his direct seller. The liability reached finally the original seller A. The Court held that B was entitled to recover from A the damages recovered in the original action by F and a sum in respect of costs incurred by themselves and C and D respectively in connection with the claims against them.

[114] Section 2-607(5)(a) of the UCC states that "Where the buyer is sued for breach of warranty or other obligation for which his seller is answerable over... he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigation, then unless the seller after reasonable receipt of the notice does come in and defend he is so bound."

cases, the aggrieved party should be able to proceed against the manufacturer directly.[115] The previous discussion shows that there is a kind of response to such a suggestion among the American jurisdictions. It is submitted that the classic rule of privity need not be strictly applied in such cases. Abolishing the requirement of privity in such cases brings the law into line of reality.

Passing the liability up chain contracts cannot be successful in at least four cases. Firstly, where a seller to an upstream contract has gone out of business or become insolvent, the chain will be broken and, hence, the liability cannot be shifted up any more. In fact, the buyer may not be able to identify the seller he purchased the goods from. This is not unusual case. In fact, the consumer who goes shopping may buy several things from different places. It is possible that the consumer may not be able to identify the seller of each item he purchased. Actually, this may also happen in cases where the buyers are not consumers. The buyer may purchase branded goods in reliance on the brand name without paying attention to the place from which he obtained the goods. Therefore, the buyer he purchases a quantity of branded goods from different places may find it difficult to identify the immediate seller of each item he purchased. As a result, the chain of contracts can be broken. For example, in the case of *Lambert and another v. Lewis and others,*[116] the chain was broken because the dealers could not identify their immediate seller of the goods.

Secondly, parties in chain contracts may shelter behind disclaimer clauses. Where one of the contracts in the chain includes clauses which exclude the liability of the seller, the buyer may not be able to recover for his liability towards his sub-buyer and, hence, liability cannot pass up further. The third case is concerned with the limitation period. By the time liability is passed up to the original seller, the limitation period of the claim may have expired. Therefore, the remote seller may have the chance to escape liability by relying on the defence of the limitation period to defend his direct buyer's claim. In such a case, there is a risk that the remote seller may escape liability. Such a risk can be avoided by allowing the ultimate buyer to sue the remote seller directly.[117]

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[115] J.E. Talman, 'On the Problem of Extension of Warranties under the Uniform Commercial Code' (1968) 1 *Conn. L. Rev.* 369, 380.
[116] [1982] AC 225. See infra, p.245.
[117] See J.N. Adams and R Brownsword, *Key Issues in Contract,* London, 1995, p.152.

The fourth case of the deficiency of this method is where the remote seller issues warranty to the ultimate buyer. In such a case, the ultimate buyer cannot sue his direct buyer for breach of such a warranty.[118] Therefore, the method of "passing up liability" would be inapplicable. Here, the court will discuss whether such a warranty is legally binding. The court will go through the above mentioned dilemma to find out whether such a warranty can furnish a legal ground for a collateral contractual relationship between the remote seller and the ultimate buyer.

6.1.4.2 The Applicability of the Method

The main issue arises in cases of passing the liability, is the level of similarity among warranties issued by the sellers in chain contracts. The case law has approached this issue by two different methods, i.e. identical warranties and similar warranties. According to the first method, the liability cannot pass up chain contracts unless warranties, issued by parties in the chain, are the same. This method can be found in *Dexters v. Hill Crest Oil Co.*,[119] where the defendant had sold dark cottonseed grease to the plaintiff who resold the seeds as black cottonseeds which are of a higher quality. The plaintiff sued the original seller to recover, as damages, what he paid to the ultimate buyer. The Court of Appeal refused to measure the plaintiff's damages by the amount he paid to his sub-buyer. In this case, Scrutton LJ pointed out that

> "... where there has been a chain of sales and sub-sales often present complications and difficulties; but one point I have always understood as clear, namely, that in order to make a sum recovered for breach of the last contract in the chain the measure of damages for a similar breach of a contract higher up in the chain, *it is essential that the contracts along the chain connecting them should be the same.*"[120] [Emphasis added].

Despite that the statement suggests that warranties should be identical, it is hard to believe that Scrutton LJ required warranties to be semantically identical. Where warranties vary in words, this may not be, for the purpose of passing the liability up the chain, a ground to hold that the warranties are different and as a result the chain is broken. The warranty may be changed semantically in order to be more valuable.[121]

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[118] See M.W., 'Retail Sellers and the Enforcement of Manufacturer Warranties: an Application of the Uniform Commercial Code to Consumer Product Distribution Systems' (1986) 32 *Wayne L. Rev.* 1049, 1075.

[119] [1926] 1 KB 348.

[120] *Dexters v. Hill Crest Oil Co.*, [1926] 1 KB 348, 359.

[121] In *British Oil & Cake Co. v. Burstall* [1923] 39 TLR 406, the Court found the buyer's modification of the original warranty did not show the goods with a better value. In this case the defendant (the original

In the famous case of *Biggin & Co. Ltd. v. Permanite Ltd.,*[122] Devlin J. made it clear that the test is whether or not the ultimate buyer's loss resulted from the original seller's breach of warranty. It seems well settled that the liability towards the ultimate buyer may pass up the chain if the ultimate buyer's loss resulted from the original seller's breach of warranty. It should be clear that the question of whether or not the variation of warranties has an effect on the ultimate buyer's loss, is a question of fact which can be decided according to the circumstances of each case. In *Biggin's* case, Devlin J. pointed out that the impact of changes in warranties depends on whether the loss is physical or economical. He said that "any variation that is more than a matter of words is likely to be fatal, because there is no way of telling its effect on the market value. In the latter case the nature of the physical damage will show whether the variation was material or not"[123]. However, if the original seller's breach was one of the causes of the ultimate buyer's loss, although it was not the only reason and/ or there was material changes in the warranty, the original seller might be held liable for the loss. If this becomes the case, his liability cannot be measured by the direct seller's liability towards the ultimate buyer since his breach was not the only cause of the loss. The liability may vary depending on whether the original seller's breach was the principal cause of loss or not.[124]

But, what would be the case if the loss was caused by a breach of a different warranty which the original seller confirmed or consented to impliedly or expressly? Obviously, in such a case, the original seller may intervene in the subpurchase contract by inducing the subpurchaser to rely on the warranty for purchasing the goods. The court may find here a legal base for a collateral contract between the original seller and the ultimate

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seller) had sold copra cake to the plaintiff. The plaintiff resold the copra cake as free from castor. The court found that the copra cake cannot be with castor; in this sense, the difference in description was immaterial to the description of the quality of the goods. Such kind of addition in the description of the quality of the goods cannot show the goods with a better quality.

[122] [1951] 1 KB 422. The case was reversed on another ground: [1951] 2 KB 314. In this case the plaintiff purchased from the defendant goods in order to be sold to the Dutch government, as the defendant was aware of that. The Dutch government resold some of the goods to contractors who found that the goods are with unsatisfactory quality. The Dutch government claimed damages from the plaintiff for compensation paid to the contractors and the loss of goods which could not be resold. The plaintiff settled the claim out of court and sued the defendant to recover, as damages, what he paid to the Dutch government. In this case Devlin J. found that there were some changes in warranties which affected the representative value of the goods, i.e. the changes in warranty was not only mere language. He held that in such cases the manufacturer's liability cannot be measured by the liability of the direct seller towards the ultimate buyer.

[123] Ibid at p.434.

buyer. The original seller's intervention may constitute an offer which meets the acceptance of the sub-buyer by the act of purchase. However, what would be the case if the original seller did not contact the sub-buyer but agreed with the buyer to sell to the sub-buyer on a different warranty? Can liability pass up to the original seller? Where such an agreement was part of the contract between the original seller and the buyer, the original seller would be bound by the agreement and, hence, liability would pass up to him. However, where the original seller agreed after he had sold the goods to the buyer, the question would turn to be whether the seller's consent and the buyer's resale amounted to a collateral contract.

The similarity of warranties is not the only restriction on passing the liability up the chain.[125] Parties should reasonably contemplate, at the time of making the contract, that there will, or probably will, be a chain of contracts following their contract.[126] In other words, parties should reasonably contemplate that the goods will, or probably will, be resold to a sub-buyer who may resell again and so on. In such cases, the remoteness principle[127] is one of the main restrictions on passing the liability up the chain. Under the remoteness principle, it should be in the reasonable contemplation of the parties that the loss is not unlikely to result from the breach. It should be in the reasonable contemplation of the parties, at the time of making the contract, that the remote seller's breach will not be unlikely to cause a breach of the series contracts and it will not be unlikely that the sub-buyers will sue their sellers for such a breach.[128]

At the last point, it should be clear that in some cases beneficiaries other than the sub-buyer use the purchased goods. If the goods caused damage to such beneficiaries, they might sue the ultimate buyer in tort or in contract.[129] Where such a damage results from the seller's breach of warranty, the ultimate buyer may recover from the seller for his liability to the third party. Here, damages may include the expenses incurred in

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[124] See the causation restriction, infra p.278.
[125] See chapter seven, infra p.277.
[126] See A. G. Guest, *Benjamin's Sale of Goods,* London, 1997, para.17-076. See also *Bostock v. Nicholson* [1904] 1 KB 725; *Pinnock v. Lewis* [1923] 1 KB 690; *Hardwick Game Farm v. Suffolk Agricultural Poultry Producers Association* [1961] 2 AC 31.
[127] See the remoteness principle, infra p.284.
[128] See the leading case of *Hammond v. Bussey* (1888) 20 QB 79.
[129] The claim in tort or contract depends on the legal relationship between the aggrieved party and the ultimate buyer.

defending the third party's claim.[130] In such a case, the claim of the third party and the liability of the ultimate buyer should be in the reasonable contemplation of the parties, at the time of making the contract, as not unlikely to result from the seller's breach of warranty.

However, in order to recover for his liability to third party from his seller, the buyer should prove that such a liability was caused by the defective goods. In *Lambert and another v. Lewis and others*[131] the ultimate buyer was not successful in his claim against his seller to recover the compensation he paid to a third party who was injured by the defective goods. The House of Lords stated that although the trailer coupling (the subject-matter of the sale contract) was defective, the damage suffered by the third party was caused by the ultimate buyer's negligence. The ultimate buyer was negligent in using the defective trailer coupling after he discovered its defect. If the damage had been caused before the buyer noticed that the trailer coupling was broken, the buyer could have recovered from his seller for his liability to the third party. Here, it should be noted that the buyer may still be entitled to recover for his liability to third party even though such a liability results from the buyer's negligence in not examining the goods. This may be the case where the buyer, as between himself and the seller, is not under a duty to examine the goods. In the leading case of *Mowbray v. Merryweather,*[132] the buyers were held liable in negligence for injury suffered by their employees due to defective goods. The buyer was found negligent due to the fact that he did not examine the goods before putting them to use. However, the buyers recovered for their liability from their seller on the ground that the injury was caused by the defect of the goods and the buyers, as between themselves and the seller, were not under duty to examine the goods.

6.1.5 Enforceability of Warranty issued by Remote Seller to the Ultimate Buyer under English law

Under current English law, the claim of the ultimate buyer against the remote seller for breach of implied warranty of quality may face the defence of lack of privity. However, this may not be the case where the remote seller issues an express warranty of quality to

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[130] Costs cannot be reasonable if they are incurred on unsuccessful appeal brought by the sub-buyer against the third party. However, where the sub-buyer's defense against the third party's claim was successful, it is very likely to be held that the costs on such a defence were reasonable. See Harvey McGregor, *McGregor on Damages,* London, 16th ed., 1997, p.598.

[131] [1982] AC 225. See infra, p.245.

[132] (1895) 2 QB 640.

the ultimate buyer. In fact, such express warranties normally provide that the remote seller undertakes to repair or replace the defective goods or refund the price. However, the seller may also indicate in an express warranty that the goods are fit for specific purpose or are of specific description. For example, the remote seller may advertise a printer as being of the capacity of printing 30 pages per minute. It is also possible that the remote seller, through advertisement or packaged warranties, guarantees the quality of the goods for a specific period of time after the time of purchase by the ultimate buyer. Moreover, it is reasonable for a person who watches a television advertisement of goods to understand that the goods are free of defects and they are fit for their general use. Here, it can be argued that such advertisements amount, at least, to a warranty that the goods are defect free and fit for their general use. In other words, such advertisements should be treated at least as promises of the remote seller that the goods will comply with the implied warranty of quality. As one American court said, "when a manufacturer puts a new automobile into the stream of trade and promotes its purchase to the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of the ultimate purchaser."[133]

The main question is whether or not the warranty of the remote seller issued to the ultimate buyer is enforceable.[134] Generally, the existence of a contractual relationship between seller and buyer is a prerequisite for the buyer's claim under the warranty theory.[135] Here, it should be noted that some American States, as illustrated below,[136] have abolished the requirement of privity in cases of breach of warranties issued by remote sellers.[137] Such a contractual relationship is required for enforcing the remote seller's warranties under English law and some American jurisdictions.[138] The

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[133] *Henningsen v. Bloomfield Motors*, 161 A.2d 69, 84; 32 N.J. 358, 384 (1960). In this case, the wife of a purchaser of an automobile had suffered physical injuries due to the defective quality of the automobile. She brought an action in contract against the manufacturer for breach of warranty action. The manufacturer was held liable regardless of the requirement of privity. Under Section 2-318 of the UCC, implied and express warranties are extended to the wife of the ultimate buyer.

[134] See P.L. Dykas, 'Opinion v. Express Warranty: How much Puff can a salesman use, if a salesman can use puff to make a sale?' (1991-92) 28 *Idaho L. Rev.* 167.

[135] However, under certain circumstances, the sub-buyer may bring an action under the 1999 Act. Supra, p.214.

[136] Infra,253.

[137] Under Section 2-318 of the UCC, privity is not a restriction for claims under the warranty theory.

[138] The manufacturers' instructions of using the goods constitute part of the goods purchased. Therefore, if the buyer uses the goods in accordance with the instructions and, nevertheless, the goods fail to fit for their purpose, the buyer may sue his immediate seller for breach of warranty of quality. In such a case, the buyer can sue his immediate seller regardless of whether the failure is due to the defective quality of the goods or to the wrong instructions. In *Wormell v. R.HM Agriculture (East)* [1986] 1 WLR 336 a farmer purchased herbicide in order to kill wild oats in his crop of winter wheat. He applied the herbicide in

contractual relationship between remote seller and ultimate buyer can take one of the following three shapes: direct contract, contract through agent and collateral contract.

As for direct contractual relationship, the buyer may be able to purchase the goods directly from the manufacturer through, as an example, mail order. Obviously, in such a case the buyer will be in a direct contractual relationship with the manufacturer and, hence, the issue of third party's claim will not arise. However, beneficiaries,[139] other than the direct buyer, are not in a contractual relationship with the manufacturer. Therefore, if they suffer damage resulting from the use of the product purchased, privity can be a defence to their claim under the warranty theory. Likewise, where the circumstances show that the dealer is an agent of the manufacturer, the buyer, who purchases from such a dealer, will be in a direct contractual relationship with the manufacturer. Plainly, in such a case, lack of privity cannot be a successful defence for the buyer's claim.

As for collateral contracts, the court in some circumstances may find the express warranty, issued by a remote seller to the ultimate buyer, sufficient enough to furnish a legal basis for collateral contract. Such a finding may be essential to hold the remote seller liable in cases where the only available action is in contract. Under English law, the enforceability of remote seller's warranties is uncertain due to the little litigation in this area. Manufacturers tend to honour their warranties in order to improve their commercial reputation.[140]

Circumstances, which furnish legal ground for contractual relationship between the buyer and remote seller, cannot be put in an exhaustive list. Contractual relationships between buyer and remote seller may be found in cases where the remote seller makes a representation about his goods to the ultimate buyer personally or to the public.[141] For

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accordance with the manufacturer's instructions. However, the herbicide had little or no effect on the wild oats. It was found that the manufacturer's instructions were misleading as understood by the buyer and a reasonable user. Thereupon, the buyer's action against his immediate seller for breach of warranty of quality was successful. In this case, the Court made it clear that in a case such as *Wormell* the buyer purchases the goods with their instructions.

[139] Such as the family members of the buyer.

[140] G. Woodroffe, 'Guarantees' in *Buying and Selling Law* (Special Report), the Chartered Institute of Purchasing and Supply, Issue 14, May 1993, p.5.

[141] In the UCC case of *Alberti v. Manufactured Homes, Inc.*, 1991 N.C. LEXIS 612; 15 UCC Rep. Serv. 2d 1184 (1991), the manufacturer made a representation concerning the flooring in its mobile homes to the seller in a conference held for the purpose of highlighting the attributes of its products. The manufacturer enabled the seller to pass the information along to consumers to induce purchases of the

example, a buyer who relies on the dealer's representation for purchasing the goods in question through a finance company may sue such a dealer in case of breach of his representation. Although the direct contractual relationship in such a case is between the buyer and finance company, the dealer's representation and the mere purchase of the goods creates a collateral contract between the buyer and the dealer upon which the dealer's warranty was held enforceable.[142] As for contractual relationship by means of representation to the public, manufacturers and distributors often advertise their goods in order to induce the ultimate buyers, mainly consumers, to buy their goods from retailers. Where the advertisement shows that the goods are of special quality or states an assurance of quality, it may furnish grounds for holding that there is a contractual relationship between the ultimate buyer and the manufacturer or distributor.[143]

The significant issue here is whether the doctrine of consideration can be satisfied by a mere warranty issued to the ultimate buyer by a remote seller. The doctrine of consideration may be satisfied where the parties have reciprocal obligations under the contract.[144] Therefore, if the ultimate buyer has nothing to do as a reciprocal action to the manufacturer's warranty, the contract may not be made. Here it can be noted that the purchase of the advertised product from a retailer can be beneficial for the manufacturer inasmuch as it increases the sale of his products by an indirect way.[145] In *Shanklin Pier Ltd. v. Detel Products Ltd.*,[146] the manufacturer assured the plaintiff that a certain kind of paint would last for at least seven years if it was applied to the pier of the plaintiff. Relying on this assurance, the plaintiff instructed its contractors to purchase the paint and use it. The paint lasted for a considerably shorter period. The Court allowed the plaintiff damages for the manufacturer's breach of his express warranty. In this case, the manufacturer's assurance and the plaintiff's purchase amounted to a unilateral contract. Thereupon, the manufacturer was liable for his failure to perform his promise, i.e. the life of the paint. This case can be an ideal example of unilateral contract where the

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homes. In this case, the court allowed a claim brought by a consumer against the manufacturer for breach of warranty of quality.

[142] This was the case in *Yeoman Credit, Ltd. v. Odgers* [1962] 1 All ER 789. See also *Andrews v. Hopkinson,* [1957] 1 QB 229; *Brown v. Sheen and Richmond Car Sales, Ltd.,* [1950] 1 All ER 1102.

[143] D.B. Nelson, 'Is Privity Still Required in a Breach of Express Warranty Cause of Action for Personal Injury Damages?' (1991) 43 *Baylor L. Rev.* 520, 563.

[144] See Hugh Collins, *The Law of Contract,* London, 3rd ed., 1997, p.56.

[145] See G. Woodroffe, supra n.140 at p.5. See also the American case of *Henningsen v. Bloomfield Motors, Inc.,* 161 A.2d 69, 78 (N.J. 1960).

[146] [1951] 2 KB 854.

consideration doctrine is satisfied by an exchange of an act for a promise.[147] In *Shanklin's* case the mere purchase of the paint, in reliance on the manufacturer's assurance, was a reciprocal act for the buyer's promise of the quality of the paint.

In certain cases, the mere use of the product may be sufficient enough to constitute an acceptance of the remote seller's promise and, hence, establish a contractual relationship between the remote seller and the ultimate buyer. In the famous case of *Carlill v. Carbolic Smoke Ball Co.*,[148] the Court found a collateral contract between the manufacturer and the ultimate buyer. In this case, the defendant advertised its product, i.e. smoke ball, as preventive against influenza. The defendant made it clear that he would pay £100 for anyone who used the smoke ball and still caught flu. The Court held that there was a contractual relationship. The requirement of consideration was satisfied by the exchange of "the act of use of smoke ball" for the manufacturer's promise. Here, suppose that the ultimate buyer did not use the Smoke ball; however, she passed it to somebody else, her relative as an example. Could such a relative sue the manufacturer in a contract action if he used the smoke ball under the instructions and, nevertheless, caught influenza? Relying on the judgment of Bowen LJ, one may answer this question in the positive. Bowen LJ pointed out that the effect of the manufacturer's promise, which it was intended to have, was to make the people use the product as distinct from the purchase of it. So, the promise and the use of the product, created a contract which is separate from the purchase contract.

The intent to create contractual relation is another requirement for making a collateral contract. Professor Beale suggests, for the purpose of making a collateral contract, that "there must be a specific statement to the customer in relation to a particular transaction which the customer is then thinking of entering."[149] In general, where the ultimate buyer purchases the goods in reliance on an express warranty of quality, issued to him by the remote seller, do the remote seller and the ultimate buyer intend to create a legal relationship? The answer is in the affirmative. The remote seller issues such a warranty

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[147] Hugh Collins, supra n.144 at p.59.

[148] (1893) 1 QB 256. This case was followed in *Harvela Investments Ltd v Royal Trust Co of Canada (CI) Ltd and Others* [1986] AC 207. In this case, the defendants invited two parties to submit sealed offers or confidential telexes for a parcel of shares and they stated in the invitation that 'we bind ourselves to accept the highest offer". It was held that this constituted an offer which was accepted by the highest bid. The act of bidding was the consideration for the promise to accept the highest offer. Clearly, in this case, there were two contracts, i.e. the contract of sale of the shares and the collateral contract, which was formulated by the promise to accept the highest offer and the act of bidding.

in order to promote his purchase and, thus, should expect the ultimate buyer to rely on such a warranty in purchasing the warranted goods. The buyer enters into the sale contract in reliance on the presumption that the goods will conform to the remote seller's warranty. This issue was well dealt with by the House of Lords in *Esso Petroleum Ltd. v. Commissioners of Customs and Excise.*[150] In this case, Esso devised a sales promotions scheme under which garage owners offered a free "World Cup Coin" with every four gallons of petrol. In dealing with the issue of whether there was a collateral contract, Lord Simon said that "I am... not prepared to accept that the promotion material put out by Esso was not envisaged by them as creating legal relations between the garage proprietors who adopted it and the motorists who yielded to its blandishments."[151] The test, regarding the requirement of intention to make legal relation, is whether the reasonable man in the position of the buyer would understand that the statement of the remote seller imports an intention to create legal relation with the buyer.[152] Obviously, the test is concerned with the apparent intention of the remote seller.[153] Therefore, where the apparent intention of the remote seller is to make a legal relationship, the remote seller cannot deny the existence of a collateral contract with the ultimate buyer by proving that it was not intended to make such a contractual relationship.

The main issue here is whether the ultimate buyer's reliance on the remote seller's warranty is necessary to furnish grounds for a collateral contract. Here, it should be noted that the buyer's awareness of the remote seller's warranty is definitely required for

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[149] Hugh Beale, supra n.75 at p.151.
[150] [1976] 1 All ER 117.
[151] Ibid at p.121.
[152] *Bowerman and Another v. Association of British Travel Agents Ltd.,* The Times, 24 November 1995. The case involve a contract of a school skiing trip made with an operator which was a member of the Association of British Travel Agents Ltd (ABTA). The operator became insolvent. However, the customers were protected by the ABTA protection scheme. The ABTA reimbursed the cost of the trip but insisted on deducting £10 per head which represented the holiday insurance premium paid on behalf of each participant in the tour. The plaintiffs claimed that they were entitled to recover all the cost of the trip under the ABTA protection scheme. The question in that case was whether there was a collateral contract between the plaintiffs and the ABTA. The statement issued by the ABTA to the customers was that "Where holidays or other travel arrangements have not yet commenced at the time of failure, ABTA arranges for you to be reimbursed the money you have paid in respect of your holiday arrangements". The Court of Appeal by a majority held that there was such a contract. Lord Waite, said that "[m]y own view is that the notice [statement of ABTA] - notwithstanding the bewildering miscellany it contains of information, promise, disclaimer and reassurance - would be understood by the ordinary member of the public as importing an intention to create legal relations with customers of ABTA members." See also K.W. Wedderburn, 'Collateral Contracts' [1959] *CLJ* 58, 77.
[153] Gerard McMeel, 'Contractual Intention: The Smoke Ball Strikes Back' (1997) 113 *LQR* 47, 49.

creating a collateral contract.[154] The issue of reliance was dealt with in the case of *Wells (Merstham), Ltd. v. Buckland Sand and Silica Co., Ltd.*[155] In this case, where the original seller breached his express warranty issued to the sub-buyer, the Court held such a warranty enforceable on the ground that there had been a collateral contract created between the sub-buyer and the original seller. The Court stated that "[a]s between A (a potential seller of goods) and B (a potential buyer), two ingredients, and two only, are in my judgment required in order to bring about a collateral contract containing a warranty: (1) a promise or assertion by A as to the nature, quality or quantity of the goods which B may reasonably regard as being made *animo contrahendi*, and (2) acquisition by B of the goods in reliance on that promise or assertion."[156] This statement makes it clear that, under English law, reliance on remote seller's warranty is required for the purpose of creating a collateral contract by which the remote seller's warranty becomes enforceable. However, it should be noted that although English law requires reliance on the seller's warranty, the court need not look into the buyer's mind to see whether he relied on the seller's warranty.[157]

One here could argue that the requirement of reliance is unfair, especially in cases of manufacturers' advertisements. In such cases, it is immaterial from the point of view of the manufacturer whether the ultimate buyer relied on his warranty for purchasing the goods or not. The manufacturers' warranties are advertised to the public for the purpose of promoting the demand for the manufacturers' products. Therefore, where the buyers are aware of such advertisements, it should not matter whether they relied in fact on such advertisements for purchasing the advertised goods. This seems quite fair in

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[154] In *Esso Petroleum Ltd. v. Commissioners of Customs and Excise,* [1976] 1 All ER 117 Lord Simon, at pp.122-3, said that "[o]f course not every motorist will notice the placard, but nor will every potential offeree of many offers be necessarily conscious that they have been made. However, the motorist who does notice the placard, and in reliance thereon drives in and orders the petrol, is in law doing two things at the same time. First, he is accepting the offer of a coin if he buys four gallons of petrol. He is himself offering to buy four gallons to petrol: this offer is accepted by the filling of his tank."

[155] [1965] 2 QB 170.

[156] *Wells (Merstham), Ltd. v. Buckland Sand and Silica Co., Ltd.,* [1965] 2 QB 170, 180. In this case, the plaintiffs who were chrysanthemum growers, asked the defendants whether their sand had the low oxide content necessary for propagating cutting. The defendants answered that it did. In reliance on that, the plaintiffs bought some of the defendant's sand from a third party. When the sand turned out to have a high oxide content, the defendants were held liable in contract.

[157] In *Oscar Chess, Ltd. v. Williams*, [1957] 1 All ER 325, Lord Denning, at p.328, pointed out that "[i]t is sometimes supposed that the tribunal must look into the minds of the parties to see what they themselves intended. That is a mistake... The question whether a warranty was intended depends on the conduct of the parties, on their words and behaviour, rather than on their thoughts. If an intelligent bystander would reasonably infer that a warranty was intended, that will suffice. And this, when the facts are not in dispute, is a question of law."

unilateral contracts where the buyer reciprocates to the remote seller's warranty by purchasing the goods in question.

In fact, the requirement of reliance seems not to be strictly applied. This is best illustrated by the decision of the Court of Appeal in *Lambert and another v. Lewis and others.*[158] The case involved a car accident in which the plaintiffs, a mother and her son, were injured and the son and the father were killed. Their car was hit by a trailer which had become detached from an on-coming car owned by a farmer. The unhitching of the trailer had resulted from the failure of the coupling connecting the trailer to the farmer's car, the design of the coupling being defective. The plaintiffs brought an action in negligence against the farmer, the driver of the farmer's car, the dealers who had supplied and fitted the coupling to the farmer's car, and the manufacturers of the coupling. The farmer brought third party proceedings against the dealers, and the dealers in turn brought fourth party proceedings against the manufacturer. The manufacturer and the farmer were held liable for the resulting damage. The Court of Appeal held the dealers liable to the farmer for his liability to the plaintiffs.[159] As the Court held so, it carried on to discuss the dealers' claim against the manufacturer, which is our concern in this case. In this case, the dealers did not buy the trailer coupling from the manufacturer. However, due to the fact that they were unable to identify the distributor who sold them the trailer coupling, they brought a claim against the manufacturer for *inter alia* breach of warranty.

In this case, the dealers relied on the decision in the aforementioned cases of *Carlill* and *Shanklin* to argue that the manufacturer was liable for breach of collateral contract. However, the Court of Appeal approved the trial judge's finding that the manufacturer's statement regarding the quality of the goods in question was not intended to be binding. Therefore, the Court of Appeal rejected the dealers' submission that the manufacturer was in breach of collateral contract. The Court stated that it is not enough, in order to hold the manufacturer contractually liable, to prove that the manufacturer's statement induced the buyer to purchase the products. The statement should be a promise which is intended to be binding. However, the question should be whether it was reasonable for

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[158] [1980] 1 All ER 978. The decision was reversed on different ground: [1982] AC 225.

[159] The decision of the Court of Appeal regarding the liability of the dealers was reversed by the House of Lords on the ground that the damage was caused by the farmer's negligence in continuing to use the trailer

the buyer to rely on the manufacturer's statement in purchasing the products. If the answer is in the positive, the manufacturer should be held liable for the defective products. Where it is reasonable to rely on the manufacturer's statements regarding the quality of the goods, the manufacturer, it is submitted, should be liable for the defective quality of goods regardless of whether or not he intended his statements to be legally binding.

Nevertheless, the Court of Appeal in *Lambert* accepted the submission that "not much is needed to conclude that when a warranty of suitability for a particular purpose is expressed or implied in a contract of sale, that warranty has been relied on by the purchaser."[160] Therefore, where the buyer is aware of the manufacturer's warranty concerning the quality of the goods, the reliance on the warranty may be inferred from the act of his purchase of the goods.

The issue of the enforceability of remote seller's warranty becomes more complicated in cases of packaged warranties. A manufacturer's warranty may be enclosed with the goods in the same package.[161] Therefore, the buyer might not know that such a warranty exists until he purchases the goods. If this becomes the case, the buyer may find it hard to show that the purchase is a reciprocal action for the remote seller's warranty. Hence, it is difficult to find a legal base for a contractual relationship between the manufacturer and such a buyer. However, one may argue that due to the rapid development in the commercial field, nowadays consumers expect electrical appliances to be warranted for a specific time by the manufacturers.[162] Ultimate buyers are likely to ask retailers about such warranties before they purchase the goods.[163] In this sense, one can point out that the existence of a contractual relationship, between the ultimate buyer and remote seller, based on such a packaged warranty is not impossible. In certain cases, the reliance of the ultimate buyer on packaged warranty seems quite clear. For example, ultimate buyers

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coupling after he had discovered the defect. Thereupon, there was no point for the House of Lords to deal with the dealers' claim against the manufacturer.

[160] *Lambert and another v. Lewis and others* [1980] 1 All ER 978, 1001.

[161] M.G. Bridge, *The Sale of Goods,* Oxford, 1997, p.375.

[162] See D.F. Clifford, 'Express Warranty Liability of Remote Sellers: One Purchase, Two Relationships' (1997) 75 *Wash. U. L. Q.* 413, 433.

[163] In case of warranty of repair, where some electrical machines have no warranty coverage of a repair, consumers may believe that the manufacturer has little confidence in the product's quality. This may lead to unsuccessful marketing of the manufacturer's products. W.C. Whitford, Comment on a Theory of the Consumer Product Warranty, (1982) 91 *Yale L.J.* 1371, 1373. See also G.L. Priest, 'A Theory of the Consumer Product Warranty' (1981) 90 *Yale L.J.* 1297.

who are used to finding packaged warranties with certain kind of goods, may rely on such warranties for further purchases of the same kind of goods. This might be the case of goods that are bought by businessmen in order to be manufactured. In such cases, one can note that a contractual relationship between remote seller and ultimate buyer is likely.

Furthermore, manufacturers may invite the ultimate buyer to fill and return a warranty card attached to the packaged warranty. By doing so, the consideration doctrine may be satisfied, especially in cases where the postage has to be paid[164] or such a card is used by the manufacturer for statistical purposes which may be quite helpful in improving his business. The return of such a card may be sufficient to be considered as a reciprocal action for the manufacturer's warranty.[165] This can make a sufficient legal basis for a unilateral contract. In cases of warranties that stipulate for notification of acceptance, Professor Atiyah sees that such a notification is not necessary to hold the warranty enforceable.[166] This might be a sensible opinion in cases where such packaged warranties had been advertised to the public or the buyer had reason to presume that such warranties accompany the goods. Here, the action of purchase can be reciprocal to the manufacturer's warranty and, consequently, the buyer does not need to fill and return the card of notification. However, where the buyer was not aware of such a packaged warranty by the time of purchase, it seems hard to see how the consideration requirement can be satisfied without filling such a notification card.

To sum up, the remote seller's express warranty can be enforceable if it furnishes a ground for collateral contract. Leaving the enforceability of such warranties to be decided according to the circumstances of each case seems to create uncertainty in English law. It is submitted that such warranties should be made legally binding by legislation. The remote seller should be held liable for his false statements regarding the quality of his products regardless of whether such a warranty amounts to a collateral contract. Professor Beale states that "[i]t hardly lies in the mouth of a manufacturer to say that information given out to boost sales of its products is unimportant."[167] As previously mentioned, the retailer should not be held liable for false statements made by

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[164] G. Woodroffe, supra n.140 at p.6.
[165] M.P. Furmston, supra n.71 at p.3.52.
[166] P.S. Atiyah, supra n.67 at p.249.
[167] Hugh Beale, supra n.75 at p.152.

the producer.[168] In fact, as Professor Beale suggests,[169] the producer should be held liable for his own breach. As discussed below, under the revised Article two of the UCC, the remote seller is responsible for his public statement regarding the quality of the goods in question.

In consumer cases, a warranty as to reimburse the price paid or to replace, repair or handle consumer goods in any way if the goods appeared defective, is enforceable under the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, as discussed above.[170] In commercial cases, where the ultimate buyer is aware of such a warranty at the time of purchasing the goods, one may strongly argue that such a warranty amounts to a collateral contract. As Chris Willet suggests that in cases of normal 'repair or replace' guarantee, the manufacturer will find it difficult to argue against the common sense presumption that the buyer relied on such a guarantee and, as a result, this will overcome any problem of consideration.[171]

6.1.6 The Position in American Law

The enforceability of warranties, issued by the remote seller to the ultimate buyer, seems to vary among the various jurisdictions of the United States. This could be due to the gap in law left by the UCC as discussed in the next section. The variations among the several jurisdictions have created uncertainty in the law. The recent draft of the revised Article 2 of the UCC is intended to reduce such uncertainty by stating provisions to deal with cases where the ultimate buyer seeks to enforce the remote seller's warranty.

6.1.6.1 Enforceability of Warranty issued by Remote Seller to the Ultimate Buyer under the UCC

Section 2-313(1)(a) of the UCC defines express warranties as "part of the basis of the bargain".[172] An express warranty issued by a remote seller to the ultimate buyer is not part of the contract of sale between the ultimate buyer and his direct seller.[173] By applying Section 2-313(1-a), the UCC cannot deal with such warranties.

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[168] Supra, p.230.
[169] Hugh Beale, supra n.75 at p.153.
[170] Supra, p.231.
[171] Chris Willet, "The Quality of Goods and the Rights of Consumers" (1993) 44 NILQ 218, 228.
[172] Section 2-313 (1) states "Express warranties by the seller are created as follows: (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise."
[173] *Taylor v. American Honda Motor Co.,* 1982 U.S. Dist. LEXIS 16765; 35 UCC Rep. Serv. 391 (1982).

Consequently, the issue of whether an express warranty, issued by a remote seller to the ultimate buyer, is legally binding has been left to be decided by the case law. Comment two to Section 2-313 makes it clear that the scope of this Section is limited to warranties made by the seller to the buyer as part of a contract for sale. Expressly, the comment provides that "the warranty sections of this Article [Article two of the UCC] are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract". The common law can definitely hold that a warranty issued by a remote seller to the ultimate buyer is enforceable in cases where such a warranty can furnish a contractual relationship.[174]

The draft of revised Article two of the UCC,[175] henceforth the Draft, considers some of the mentioned issues regarding express warranty. Section 2-313B of the Draft deals with the warranty made by the remote seller in a medium for communication to the public.[176] The Section makes the enforceability of such warranty subject to the condition that the remote buyer, i.e. the buyer who is not in a contractual relationship with the seller, enters into a transaction of purchase with knowledge of and with the expectation that the goods will conform to the warranty. The question here is whether the Section, when the Draft comes into force, will create changes in the current law regarding the enforceability of such warranties. In fact, where the ultimate buyer relies on the manufacturer's warranty for purchasing the goods, such a buyer may argue that by the action of purchase he entered into two contracts, i.e. the sale contract and the collateral contract with the remote seller who issued the warranty. Therefore, under the American common law, such a buyer can bring a contract action against the remote seller. Consequently, one can point out that Section 2-313B(b) of the Draft states the current position in the American common law. Probably, the significance of the Section is to avoid any variation among the several jurisdictions of the USA.

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[174] See C. R. Reitz, 'Manufacturer's Warranties of Consumer Goods, (1997) 75 *Wash. U. L. Q.* 357, 361.

[175] The draft of March 2000.

[176] Section 2-313B(b) states "If a seller makes an affirmation of fact or promise that relates to the goods, or provides a description that relates to the goods, or makes a remedial promise, in a medium for communication to the public, such as advertising, and the remote purchaser enters into a transaction of purchase *with knowledge of and with the expectation that the goods will conform to the affirmation of fact, promise, or description, or that the seller will perform the remedial promise,* the seller has an obligation to the remote purchaser that the goods will conform to the affirmation of fact, promise or description unless a reasonable person in the position of the remote purchaser would not believe that the affirmation of fact, promise or description created an obligation...." [Emphasis added].

Under the Draft, the requirement of reliance seems to be abolished in cases of warranties created by records packaged with or accompanying the goods. Section 2-313A(b) of the Draft provides that

> "If a seller makes an affirmation of fact or promise that relates to the goods, or provides a description that relates to the goods, or makes a remedial promise, in a record packaged with or accompanying the goods, *and the seller reasonably expects the record to be, and the record is, furnished to the remote purchaser,* the seller has an obligation to the remote purchaser that the goods will conform to the affirmation of fact, promise or description unless a reasonable person in the position of the remote purchaser would not believe that the affirmation of fact, promise or description created an obligation" [Emphasis added].

Clearly, Section 2-313A(b) of the Draft makes the enforceability of the packaged warranty subject to the condition that the remote seller reasonably expects such a warranty to be, and the warranty is, furnished to the buyer. However, the purpose of the condition that the manufacturer reasonably expects that his warranty will be furnished to the ultimate buyer is unclear. If the warranty is accompanying or packaged with the goods, it will definitely be furnished to the ultimate buyer by delivering the goods to him. It seems difficult to envisage cases where it is not reasonable for the remote seller to expect the packaged warranty to be furnished to the ultimate buyer. Furthermore, the Section does not mention the time at which the warranty should be furnished to the ultimate buyer. Since the Section does not require the buyer's reliance on the warranty to purchase the goods, it seems that the warranty should be enforceable regardless of whether it was furnished to the buyer at the time of purchase or the time of delivery. However, as the Section clearly states, the warranty will not be enforceable if a reasonable person in the position of the remote purchaser would not believe that such a warranty creates an obligation.

The Draft does not deal with the liability of the remote seller for breach of implied warranty. Therefore, where the ultimate buyer suffers a loss resulting from breach of implied warranty of quality, the issue of whether the ultimate buyer can sue the remote seller for breach of warranty has been left to be decided under the common law. As will be seen, there seems to be a variation among the several American jurisdictions regarding this issue. Under the jurisdictions, which have abolished the requirement of privity, such a claim is permissible. However, this may not be the case of other jurisdictions which apply the requirement of privity.

In both cases of warranty, communicated to the public or packaged with the goods, the Draft states provisions for the quantification of damages where the claim is brought by the ultimate buyer. The provisions are, to some extent, similar to those concerned with the quantification of damages where the claim is brought by the direct buyer. The measure of damages here is *prima facie* the difference between the value of the goods as warranted and their actual value as received.[177] Furthermore, where consequential loss results from the remote seller's breach, the aggrieved party, i.e. the ultimate buyer or one of other beneficiaries, can recover for such loss under Section 2-715 which is concerned with the recoverability of such losses. However, the aggrieved party, here, cannot recover for his loss of profit resulting from the remote seller's breach of his express warranty.[178] Disallowing the ultimate buyer damages for his lost profit, resulting from an express warranty issued by a remote seller, seems to be hardly understandable. The most significant loss in cases of businessman buyer is likely to be his loss of profit. Disallowing the buyer to recover for his lost profit will obviously undercompensate him. The purpose of such a provision is unclear.

6.1.6.2 Enforceability of Warranty issued by Remote Seller to the Ultimate Buyer under the American Common Law

As previously mentioned, the UCC does not apply to the enforceability of warranty issued by the remote seller to the ultimate buyer. Therefore, the issue is left to be decided under the common law. Under most of the jurisdictions of the United States, the enforceability of the express warranty, issued by the remote seller to the ultimate buyer, is beyond question as discussed below.[179] Under the jurisdictions which apply the requirement of privity, the ultimate buyer may need to show that he has entered into a contractual relationship with the remote seller by purchasing the warranted goods. Where the buyer purchases goods from an agent of the manufacturer, the ultimate buyer

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[177] Comment 8 to Section 2-313A of the Draft provides "As a rule, a remote purchaser may recover monetary damages measured in the same manner as in the case of an aggrieved buyer under Section 2-714, including incidental and consequential damages to the extent they would be available to an aggrieved buyer. In the case of an obligation that is not a remedial promise, the measure of damages would normally be the difference between the value of the goods if they had conformed to the seller's statements and their actual value..."

[178] Section 2-313A(d-2) of the Draft states "Subject to a modification or limitation of remedy, a seller in breach is liable for incidental or consequential damages under Section 2-715 but the seller is not liable for lost profits."

[179] Infra, p.252.

will be in a direct contractual relationship with the remote seller as discussed above.[180] For example in *Massey-Ferguson, Inc. v. James W. Laird,*[181] where the plaintiff purchased a model 760 combine, manufactured by Massey-Ferguson, from Boyd, the Court found that Boyd was acting as an agent for the manufacturer. In this case the Court held the manufacturer contractually liable for his breach of express warranty of quality.

Furthermore, the buyer may seek to prove that the remote seller's warranty has furnished a legal ground for a collateral contract. As previously argued, the buyer may purchase the goods in reliance on the remote seller's warranty. If this becomes the case, the ultimate buyer may argue that he is in a collateral contractual relationship with the remote seller. For such a purpose, the reliance on the remote seller's warranty for purchasing the goods seems to be required. For example, in *Cipollone v. Liggett Group, Inc.*,[182] the United States Court of Appeals for the Third Circuit held the manufacturer liable for breach of his advertised warranty of the goods' quality. In this case, the Court reached its decision after the consumer had shown evidence that she had been aware of the advertisement before the time she purchased the goods. In this sense, the buyer's knowledge of the remote seller's representation and the expectation that the advertised goods will be in conformity with it, seem to be prerequisites for holding the remote seller liable for breach of a contractual relationship with the ultimate buyer. "If the manufacturer's representations were made in such a way that the natural tendency was to induce the sub-purchaser to rely upon them, one could spell out the promise or offer of the manufacturer to be bound. Then if the sub-purchaser accepted this offer and did the acts requested by the manufacturer it would seem proper to hold the manufacturer liable directly to the sub-purchaser upon the unilateral contract that was thereby created."[183]

Controversially,[184] some writers suggest that under the American law the principle of consideration does not require reliance.[185] However, some UCC cases have stated that

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[180] Supra, p.239.
[181] 1983 Ala. LEXIS 4413; 36 UCC Rep. Serv. 437 (1983).
[182] 893 F.2d 541 (3d Cir. 1990).
[183] L.R. Jeanblanc, 'Manufacturer's Liability to Persons other than their Immediate Vendees' 24 *Va. L. Rev.* 134, 149.
[184] See W.K. Lewis, supra n.6 at pp.688-691, where the writer deals with different opinions of several writers, such as White, Summers, Nordstrum and Murray. The writer reaches the conclusion that reliance is not required.

enforceable express warranties require reliance.[186] The American court in such cases based its decision on the requirement of the UCC that express warranty should be "part of the basis of the bargain".[187] However, as previously discussed, the UCC does not apply to warranties issued to remote buyers and the issue has been left to be dealt with by the case law. The case law requires the purchase to be a reciprocal action for the seller's warranty. Here, does the mere purchase indicate that the buyer relies on the seller's warranty for purchasing the goods? The point is illustrated in the Restatement (Second) of Contracts as follows:

> "A offers to buy a book owned by B and to pay B $10 in exchange therefor. B accepts the offer and delivers the book to A. The transfer and delivery of the book constitute a performance and are consideration for A's promise.... This is so even though A at the time he makes his offer secretly intends to pay B $10 whether or not he gets the book, or even though B at the time he accepts secretly intends not to collect the $10"[188]

Therefore, under the American law, the mere purchase of the goods, as a reciprocal action for the seller's warranty, may be sufficient enough to create a collateral contract. Professor Whitman proposes that courts indulge in a rebuttable presumption that reliance on warranty exists unless proven otherwise.[189]

6.1.6.3 The Requirement of Privity among the Several States of the USA

There seems to be no coherent attitude among the American jurisdictions towards the application of privity. The applicability of the privity requirement varies depending on whether the ultimate buyer sues for breach of express or implied warranty. Also, the applicability of privity varies depending on the kind of loss suffered. Whereas some

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[185] See M.J. Duchemin, 'Whether Reliance on the Warranty is Required in a Common Law Action for Breach of an Express Warranty?' (1999) 82 *Marq. L. Rev.* 689. The writer here discusses non-UCC cases where the requirement of reliance varies among the several jurisdictions in the USA. See also R.E. Speidel, 'Warranty Theory, Economic Loss, and the Privity Requirement: Once More into the Void' (1987) 67 *B.U. L. Rev.* 9, 14; S. Kwestel, Freedom from Reliance: a Contract Approach to Express Warranty, (1992) 26 *Suffolk U. L. Rev.* 959, 986. See also *Panto v. Moore Business Forms Inc.,* 547 A.2d 260 (N.H. 1988) where it was held that promise is enforceable even though the promise did not in fact induce promisee's performance.

[186] See *Royal Typewriter Co., Inc., v. Xerographic Supplies Corp.,* 719 F.2d 1092 (11th Cir. 1983); *Alpert v. Thomas,* 643 F. Supp. 1406 (D. Vt. 1986).

[187] See Section 2-313(1)(a) of the UCC.

[188] Section 71, illustration 1.

[189] Whitman, 'Reliance as an Element in Product Misrepresentation Suits: A Reconsideration' (1982) 35 *Southwestern Law Journal* 741, 747.

States have abolished the requirement of privity in all kinds of loss resulting from breach of warranty,[190] some other States still require privity in cases of economic loss.

As regards cases of physical loss, the prevailing view[191] among the American jurisdictions seems to be that privity cannot be a defence in cases of physical loss.[192] This applies equally to all physical losses[193] resulting from breach of express or implied warranty.[194] This is presumably because privity cannot apply where the aggrieved party sues the remote seller in tort. Therefore, it does not make sense to let the seller escape liability in contract where he could be liable in tort.

As for economic loss, the requirement of privity depends on whether the warranty is express or implied.[195] In most cases, where economic loss results from breach of express

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[190] The States of Maine, Massachusetts, New Hampshire, and Virginia have abolished the requirement of privity in cases of breach of warranty. See R.C. Ausness, 'Replacing Strict Liability with a Contract-Based Products Liability Regime' (1998) 71 *Temp. L. Rev.* 171, n.136. See also *Greenman v. Yuba Power Products, Inc.,* 59 Cal. 2d 57, 377 P.2d 897 (1962) where the Supreme Court of California pointed out that in order to impose liability on the manufacturer for the consumer's loss, the consumer need not show that an express warranty has been created as defined by California statute. In this case, the husband of the buyer brought a successful action in tort for defective power tool which was given to him as a present.

[191] See W.K. Lewis, supra n.6 at n.49; D.G. Epstein, 'Personal Injuries from Defective Products-Some "Dots and Dashes"' (1967) 9 *Ariz. L. Rev.* 163, 171; A. Devience, Jr., 'the Developing Line between Warranty and Tort Liability under the Uniform Commercial Code: Does 2-318 Make a difference?' (1990) 2 *DePaul Bus. L.J.* 295, 307. See the leading case of *Speed Fasteners, Inc. v. Newson,* 382 F.2d 395 (10th Cir. 1967) where the United States Court of Appeals for the Tenth Circuit held that "[i]n general, privity is not essential where an implied warranty is imposed by law on the basis of public policy." See also *Williams v. West Penn Power Co.,* 467 A.2d 811 (Pa. 1983) where the court rejected the defence of privity in cases of personal injury. However, see *Chance v. Richards Mfg. Co.,* 499 F. Supp. 102 (D. Wash. 1980) where the court held that privity required even in cases of personal injury.

[192] For example, it has been enacted in the Tennessee Public Act ch.670 that "[i]n all causes of action for personal injury or property damage brought on account of negligence, strict liability or breach of warranty, including actions brought under the provisions of the Uniform Commercial Code, privity shall not be a requirement to maintain said action." See also J.H. Holman, 'Breach of Implied Warranty in Personal Injury Actions' (1981) 12 *Tex. Tech. L. Rev.* 1002.

[193] As for the abolishment of the requirement of privity in cases of property damage, see R.C. Ausness, supra n.190 at p.196.

[194] The requirement of privity in cases of defective food has long been abolished in all the jurisdictions of the USA. In *Jacob E. Decker and Sons, Inc. v. Capps*, 164 S.W.2d 828 (1942), where the plaintiffs suffered physical injury resulting from poisonous food, the Supreme Court of Texas held that in such a case warranty is not imposed by law as a matter of public policy. See W.H.E. Jaeger, 'How Strict is the Manufacturer's Liability? Recent Developments' (1964-65) 48 *Marq. L. Rev.* 293, 299. The same applies in cases of defective medicine. In *Allen v. G.D. Searle & Co.*, 708 F.Supp. 1142 (D. Or. 1989), where patient received defective medicine, the Court held that the patient could sue the manufacturer notwithstanding lack of vertical privity. In cases of cigarettes, the United States Court of Appeals for the Third Circuit held, in *Pritchard v. Liggett & Myers Tobacco Co.* 295 F.2d at 297-299 (1961), that where the foreseeable use of products is dangerous to human life unless certain precautions are taken, the manufacturer is under a duty to warn the user of such consequences and to advise proper precautions.

[195] See R.E. Speidel, supra n.11 at p.319. In some cases, the court held that privity is not required in cases of breach of warranty whether express or implied. See *Moscatiello v. Pittsburgh Contractors Equip. Co.,* 407 Pa. Super. 378; 16 UCC Rep. Serv. 2d 86 (1991).

warranty issued to the ultimate buyer, privity has not been required.[196] This may be certain in cases where the buyer proves his reliance on the express warranty for purchasing the goods in question.[197] For example, the State of New York[198] has abolished the requirement of privity in both cases of physical injury and economic loss resulting from breach of express warranty.[199] In the UCC case of *Randy Knitwear, Inc., v. American Cyanamid Company,*[200] the defendant was a manufacturer of chemical resins, marketed under the registered trade-mark "Cyana", which are used by textile manufacturers and finishers to process fabrics in order to prevent them from shrinking. The manufacturers of textile were licensed or otherwise authorized by the defendant to treat their goods with "Cyana" label and with the guarantee that they were "Cyana" finished. The defendant represented and guaranteed that "Cyana" finished fabrics would not shrink or lose their shape when washed. The presentation took the form of written statements expressed in advertisements appearing in trade journals, direct mail pieces to clothing manufacturers and also in labels or garment tags furnished by the defendant. In this case, the plaintiff purchased the fabrics in reliance on such a presentation. The Court held that the privity doctrine is not a requirement in such a case. The Court pointed out that where advertisements induce consumers to purchase the goods advertised, the privity doctrine cannot be a defence. In this case, the Court did not discuss whether or not there was a contractual relationship between the plaintiff and the defendant although the facts of the case seem sufficient enough to furnish a ground for collateral contract. This case can be a strong example on the new formulation of the American law regarding the rules of contract law.

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[196] See D.I. Wallach, *The Law of Sales under the Uniform Commercial Code,* Boston, 1981, Cumulative Supplement 1991, p.76.

[197] This can be most likely in cases where the manufacturer provides samples to the seller since such samples may induce the buyer to buy the goods. See, for example, the decision of Texas Civil Appeal Court in *Indust-Ri-Chem Laboratory, Inc. v. Par-Park Co.,* 602 S.W.2d 282 (1980).

[198] See N. Deutsch, 'Seller's Liability to Remote Purchasers and Nonpurchasers for Physical and Economic Loss in Breach of Warranty Actions in New York: An Analysis of the Privity Defense and the Views of Professor Speidel and the Article 2 Study Group' (1989) 54 *Alb. L. Rev.* 35; J.P. Zammit, 'Manufacturer's Responsibility for Economic Loss Damages in Products Liability Cases: What Result in New York?' (1974) 20 *New York Law Forum,* 81.

[199] The same has been applied in Vermont in the case of *Mainline Tractor & Equip., Inc. v. Nutrite Corp.* 937 F. Supp. 1095 (1996); Washington in the case of *Daughtry v. Jet Aeration Co.,* 91 Wash. 2d 704; Tennessee in the case of *Walker v. Decora, Inc.* 471 S.W.2d 778 (1971); New Jersey in the case of *Spring Motors Distrib., Inc. v. Ford Motor Co.*, 98 N.J. 555, 489 A.2d 660 (1985); Delaware in the case of *Autrey v. Chemitrust Indus. Corp.*, 362 F. Supp. 1085 (D.C.Del. 1973).

[200] 1962 N.Y. LEXIS 1363; 181 N.E.2d 399 (1962). The case was discussed in Law Commission, *Implied Terms in Contracts for the Supply of Goods,* Law Com No 95, para.126.

However, in cases of economic loss resulting from breach of *implied* warranty, the applicability of privity widely varies from State to another. Whereas some States still retain the requirement of privity in such cases,[201] others have gone forward to abolish such a requirement.[202] In the States, which retain the requirement of privity, the ultimate buyer who suffers economic loss due to the remote seller's breach of implied warranty of quality would be left without a remedy. This is due to the application of the "economic loss rule" in the USA. Under such a rule, the aggrieved party cannot sue in tort for purely economic loss. It is submitted that such an attitude creates a gap in the law which needs intervention by the legislature in such States. Under English law, it was argued above that there seems to be an authority to allow the buyer to recover from the seller for the economic loss suffered by the sub-buyer as a result of the original seller's breach of warranty. The recovered damages must be held by the buyer for the sub-buyer.[203] Such an authority is not available under those jurisdictions which do not allow the sub-buyer to recover from the original seller for economic loss caused by the original seller's breach of warranty of quality.

In some cases, damages were allowed for the diminution in value of the goods and refused for the consequential losses suffered by the ultimate buyer. For example, in *Beyond the Garden Gate, Inc. v. Northstar Freeze-Dry Manufacturing, Inc.,*[204] where the ultimate buyer suffered normal and consequential economic losses, it was held that the remote seller is liable for the normal loss, i.e. the diminution in value of the goods purchased. In this case, the Supreme Court of Iowa applied the privity defence in respect to consequential economic losses. The Court stated that "even if relevant policies justify allowing non-privity consumers to recover for direct economic loss, there can be no justification in the usual case for allowing non-privity consumer buyers to recover for

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[201] See *Szajua v. General Motors Corp.*, 503 N.E.2d 760 (Ill. 1986); *Hadar v. Concordia Yacht Builders, Inc.*, 886 F. Supp. 1082 (S.D.N.Y. 1995); *Professional Lens Plan, Inc. v. Polaris Leasing Corp.*, 675 P.2d 887 (Kan. 1984); *Necktas v. General Motors Corp.* 357 Mass. 546; 259 N.E.2d 234 (1970); *Baughn v. Honda Motor Co.*, 727 P.2d 655 (Wash. 1986); *Lamb v. Georgia-Pacific Corp.*, 392 S.E.2d 307 (Ga. App. 1990).

[202] See *Morrow v. New Moon Homes, Inc*, 548 P.2d 279 (Ala. 1976); *Israel Phoenix Assur. Co. v. SMS Sutton, Inc.*, 787 F.Supp 102 (W.D. Pa. 1992); *Hubbard v. General Motors Corp.* 1996 U.S. Dist. LEXIS 6974 (1996); *Denny v. Ford Motor Co.*, 87 N.Y.2d 248; 28 UCC Rep. Serv. 2d 15 (1995); *Crest Container Corp. v. R.H. Bishop Co.*, 111 Ill. App. 3d 1068 (1982); *Mt. Holly Ski Area v. United States Elec. Motors*, 666 F. Supp. 115 (E.D.Mich. 1987). Some American courts have gone too far to decide that implied warranty is, by its nature, a contractual agreement and is collateral to the sales contract, such as the decision of the Texarkana Court of Civil Appeals in *Darr Equip. Co. v. Owens*, 408 S.W.2d 566, 569 (1966).

[203] Infra, 263.

[204] 526 N.W.2d 305(1995).

consequential economic losses they sustain."[205] The Court based its opinion on the ground that it is hard for remote sellers to predict the purposes for which the goods will be used. However, this result can be reached by the application of the normal restrictions imposed on the recovery of damages. Under such principles, the seller cannot be liable for unforeseeable losses nor can he be liable for losses resulting from unforeseeable use of the goods. In view of this, the Court misdirected itself by deciding the applicability of privity on the kind of economic loss suffered.

6.1.7 Enforceability of Warranty issued by Remote Seller to the Ultimate Buyer under the CISG

The issue of third party's claim seems not within the scope of the CISG. The scope of the Convention does not go beyond parties to international sale contracts.[206] Article 1(1) of the CISG states that the Convention applies to "contracts of sale of goods *between parties* whose places of business are in different States...". Article 4 makes it clear that the Convention "governs only the formation of the contract and the rights and obligations of *the seller and the buyer arising from such a contract...*". Moreover, Article 35(1) provides that "the seller must deliver goods which are of the quantity, quality and description *required by the contract and which are contained or packaged in the manner required by the contract...*". It is quite plain that the Convention applies the privity doctrine by restricting its application to claims brought by one of the parties to the contract. So where a Canadian merchant sells goods to a French buyer who resells to an Egyptian buyer, a contract action for breach of warranty of quality brought by the Egyptian buyer against the Canadian will face the defence of lack of privity.

However, where the manufacturer participates in the contract of sale between the dealer and the ultimate buyer, this may, as Professor Honnold suggests,[207] amount to a collateral contract between the manufacturer and the ultimate buyer. As discussed above,[208] the manufacturer may advertise his goods in order to promote their purchase. So where such an advertisement indicates a warranty of the quality of the goods, the buyer may rely on the advertisement when purchasing the goods. This situation may

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[205] *Beyond the Garden Gate, Inc. v. Northstar Freeze-Dry Manufacturing, Inc.,* 526 N.W.2d 305, p.309 (1995).
[206] R.E. Speidel, 'The Revision of UCC Article 2, Sales in Light of the United Nations Convention on Contracts for the International Sale of Goods' (1995) 16 *Nw. J. Int'l L. & Bus.* 165, 179.
[207] J.O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention,* Deventer, 2nd ed., 1991, pp.112-114.
[208] Supra, p.238.

amount to a unilateral contract between the manufacturer and the ultimate buyer. However, the fact that there is a unilateral contract might not be enough to allow the ultimate buyer to bring a suit against the manufacturer under the CISG. Article 4 restricts the application of the Convention to disputes arise between the buyer and the seller in relation to the contract made under the Convention. The participation of manufacturer in the ultimate sale contract may not make him the seller. However, this cannot be considered as an impassable barrier where the manufacturer participates substantially in the ultimate sale contract, such as the case where the manufacturer personally contacts the ultimate buyer and persuades him to buy his products from the dealer.[209] In such cases, it is submitted that the Convention should be applicable, especially where the immediate seller has suffered financial failure or has disappeared from the market.

In normal circumstances, consumers may find it difficult to sue manufacturers who are based in another country. It is easier for them to sue their direct seller or the manufacturer's representative or branch that is based in their country.[210] This might be the reason that the Department of Trade and Industry proposed in 1992 that "the retailer should be jointly and severally liable with the manufacturer for the manufacturer's guarantee to a consumer."[211]

6.2 Seller's Liability for Losses Suffered by a Beneficiary other than the Ultimate Buyer

This title is concerned with horizontal privity. Horizontal privity is a term used to describe the relationship between the retailer and a person who has used or consumed the goods, other than the buyer. The issue here is whether the retailer's warranty of quality extends to beneficiaries other than the buyer. In other words, can the lack of privity be a defence in a claim brought by such beneficiaries, other than the buyer, against the retailer?

Where a beneficiary sues a remote seller for breach of warranty issued to the ultimate buyer, the court needs to discuss two points, i.e., whether the remote seller's warranty is

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[209] J.O. Honnold, supra n.207 at p.114.
[210] EC's Green Paper on "Guarantees for Consumer Goods and After-Sales Services", COM (93) 509, p.87. See Stephen Weatherill, 'Consumer Guarantees' (1994) 110 *LQR* 545.
[211] DTI, February 1992.

enforceable (vertical privity) and whether such a warranty extends to the beneficiary (horizontal privity). Some writers use the expression of "Diagonal privity" to describe the relationship between the remote seller and beneficiaries other than the ultimate buyer.[212]

6.2.1 The Position in English Law: Does the Contracts (Rights of Third Parties) Act 1999 make a difference?

Under English law, warranty does not extend to people other than the person to which it is addressed. As previously discussed, beneficiaries other than the buyer will not be allowed to bring an action under the purchase contract unless the action falls under the 1999 Act.[213] However, it has been submitted that the court should go beyond the 1999 Act to relax the rigour of the privity doctrine in cases of string contracts. The impact of this proposition is to allow the seller's warranty to extend to the sub-buyer where the subsale was in the contemplation of the parties at the time of making the contract. The same should be submitted in cases of beneficiaries other than the ultimate buyer. Where it was in the contemplation of the parties, at the time of making the contract, that the goods would be used by someone other than the buyer, the third party beneficiary should be entitled to sue the seller under the contract for breach of warranty of quality.[214] Such a claim is allowed in other areas of contract law. For example, beneficiaries of contract, made between a customer and an organizer or a retailer for a package holiday, have contractual rights although they are not parties to the contract.[215]

As previously mentioned,[216] the Law Commission Report, *Privity of Contract: Contracts for the Benefit of Third Parties*,[217] makes it clear that the 1999 Act may provide help in cases of horizontal privity.[218] The Law Commission Report provides an

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[212] The term of "diagonal privity" has been invented by Professor Ezer. See Ezer, 'the Impact of the Uniform Commercial Code on the California Law of Sales Warranties' (1961) 8 *UCLA L. Rev.* 281.

[213] Supra, p.213.

[214] Unfortunately, The EC's Green Paper on "Guarantees for Consumer Goods and After-Sales Services", COM (93) 509 has not discussed the extension of warranties. It dealt only with manufacturer's warranties by suggesting that the manufacturer's liability for the consumer's consequential losses, resulting from the manufacturer's breach of warranty, is to be left for the Member States without attempting harmonization. Here, the issue of extended warranty should not have been ignored specially in cases where the loss is economic.

[215] Package Travel, Package holidays and Package Tours Regulations 1992. See J. Beatson, *Anson's Law of Contract*, Oxford, 27th ed., 1998, p.422.

[216] supra, p.215.

[217] Law Com. No. 242.

[218] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.7.54.

example of the buyer who makes it clear to the seller that he is purchasing the goods in order to give them to his friend as a gift. If the buyer asks the seller to deliver the goods to his friend, who is identified by name, the third party (the friend) may sue the seller under Subsection 1(1-b) of the 1999 Act.[219] However, Subsection 1(1-b) of the 1999 Act may not apply where the third party is not expressly identified (Subsection 1(3)) or if, on proper construction of the contract, the seller can argue that he did not intend to confer a legal right on the third party (Subsection 1(2)).

The requirement of *express* identification of the third party seems to be unfair in certain cases of consumer sale. For example, suppose that a man entered a female clothes shop and bought a coat for his mother. If the buyer did not mention to the seller that the coat is for his mother, the mother would not be able to sue the seller under the 1999 Act for the defective coat since Section 1(2) of the Act requires *express* identification. Although in such a case it is reasonable for the seller to expect that the female coat is for a third party due to the nature of the goods and the buyer, the 1999 Act will not allow the third party's action since the third party is not *expressly* identified. Indeed, the Law Commission Report makes it clear that the 1999 Act allows the third party's action "where there is express identification by name, description or class. It follows that... third party rights cannot be conferred on someone who is *impliedly* in mind."[220] However, there should be special treatment for the case where the nature of the goods indicate that the goods are bought for a third party beneficiary. It was previously stated that it seems possible to argue that the court may go beyond the boundary of the 1999 Act if it decides, as the Law Commission suggests,[221] that the 1999 Act does not go far enough.[222] This may be the case where the court finds out that the 1999 Act does not offer consumers enough protection. It is submitted that where the nature of the goods indicates that they are bought for a third party beneficiary, such a beneficiary should be entitled to bring a contract action against the seller if the goods appeared defective. In other words, it is submitted that the seller's warranty should extend to third party beneficiary where it was reasonable for the seller at the time of making the contract to contemplate that the proprietary interest in the goods will be transferred to such a

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[219] See the example provided by the Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.7.41, on the application of Section 1(1-b) of the 1999 Act to sale of goods cases where the goods are bought for a third party.
[220] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.8.1.
[221] Ibid, para.5.10.

beneficiary. The seller should honour his warranty regardless of whether the goods have been used by his direct buyer or other expected beneficiaries.[223] If this submission is ever accepted, two points should be taken into account. Firstly, in order to avoid subjecting the seller to double liability for the same loss, the buyer should not be allowed to sue the seller for losses suffered by the third party. Indeed, the seller should not be liable to the buyer and the third party for the same loss. Secondly, the seller should be allowed to defend the third party's action as if such an action had been brought by the buyer.

Here, it is worth noting that the requirement of identifying the third party, for the purpose of applying the 1999 Act, seems not to be found under the American Restatement (Second) of Contracts. The intended third party beneficiary can bring a contract action against the promisor. Section 302(1) defines the third party beneficiary as follows: "[u]nless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and... the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance." Although Section 302(1) does not require the third party to be identified by name, the contemplation of the parties that the benefit of the contract will be conferred on a third party seems not enough to allow the third party to bring a contract action against the original promisor.[224] The Section requires the parties to intend that the third party will have contractual rights under the contract.[225] Therefore, under Section 302(1) the contemplation of the parties, at the time of making the contract, that the goods will be resold seems not enough to allow the sub-buyer to sue the original seller under the contract. However, the privity requirement has been abolished in cases of remote seller's liability under some jurisdictions of the USA. As previously discussed, under certain jurisdictions, the ultimate buyer may sue the remote seller for breach of warranty of quality regardless of the fact that there is no contractual

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[222] Supra, p.217.

[223] Under this submission, the warranty should be derivative: that is to say that the existence, scope and validity of this warranty can be determined in reliance on the terms of the contract. Unlike derivative warranty, collateral contract made between the ultimate buyer and a remote seller does not depend in its existence, scope or validity on the terms of the contract concluded between the ultimate buyer and his direct seller. See R.A. Anderson, *Anderson on the Uniform Commercial Code,* 3rd ed., 1995, p.313.

[224] H.G. Prince, 'Perfecting the Third Party Beneficiary Standing Rule under Section 302 of the Restatement (Second) of Contracts' (1984) 25 *B.C. L. Rev.* 919, 969.

[225] See *American Financial Corp. v. Computer Services Corp.,* 1983 U.S. Dist. LEXIS 18792; 558 F. Supp. 1182 (1983).

relationship between the remote seller and such a buyer.[226] Furthermore, the following section will explain that beneficiaries other than the buyer may sue the seller for breach of warranty under Section 2-318 of the UCC.

Where the 1999 Act does not go far enough to protect consumers, the court should bring about justice by considering the Law Commission Report[227] in order to go beyond the boundary of the 1999 Act to allow the third party beneficiary to bring a contract action against the seller. It can also be argued that the court should allow the buyer to recover damages for the loss suffered by such a beneficiary. In fact, the latter alternative was one of the options considered by the Law Commission for a law reform. However, the Law Commission rejected this option for the reason that "the promisee may be either unwilling or unable to enforce a contract made for a third party."[228] Nevertheless, such an exception to the doctrine of privity has not been abolished by the 1999 Act. Subsection 7(1) provides that the 1999 Act "does not affect any right or remedy that exists or is available apart from the Act." In fact, the Law Commission Report makes it clear that the 1999 Act is not intended to cast any doubt on the development in the common law rules which allow the promisee to recover damages on behalf of the third party. This is significant in cases where the third party is unable to bring a claim under the 1999 Act. The Law Commission Report provides

> "[i]ndeed it is important to emphasise that, while our proposed reform will give some third parties the right to enforce contracts, there will remain many contracts where a third party stands to benefit and yet will not have a right of enforceability. Our proposed statute carves out a general and wide-ranging exception to the third party rule but it leaves that rule intact for cases not covered by the statute. On the facts of (*Linden Gardens Trust Ltd v. Lenesta Sludge Disposals Ltd* [1994] 1 AC 85) itself, there would be no question of the third party having a right of enforcement under our proposed reform.... The recognition in that case that the promisee could have recovered damages based on the third party's loss will be as important after the implementation of our proposed reform as it is under the present law...".[229]

The development in the common law regarding the recovery of damages for losses suffered by third party seems to be in areas other than sale of goods. However, as discussed below, there is nothing to prevent such an exception to apply to sale of goods

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[226] Supra, p.251.
[227] Supra, p.217.
[228] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.5.4.
[229] Ibid, para.5.16.

cases where the buyer purchases the goods for a third party who cannot sue the seller or the buyer for the defective goods.

The general rule under English law is that the plaintiff cannot recover damages for losses suffered by a third party.[230] However, in *Jackson v. Horizon Holidays Ltd.*,[231] where the plaintiff and his family suffered mental distress due to a breach of package holiday contract, Lord Denning MR decided that in such a case the plaintiff is entitled to recover damages for his loss and the loss suffered by his family. In *Woodar Investment Development Ltd. v. Wimpey Construction Co. Ltd.*,[232] the House of Lords rejected the general view of Lord Denning MR that the plaintiff may recover damages for losses suffered by a third party. However, Lord Wilberforce stated that although the general view of English law is to disallow the party to recover damages for losses suffered by a third party, *certain cases call for special treatment*. In this case, Lord Wilberforce said

> "I am not prepared to dissent from the actual decision in that case [*Jackson's* case]. It may be supported either as a broad decision on the measure of damages (per James L.J.) or possibly as an example of a type of contract— examples of which are persons contracting for family holidays, ordering meals in restaurants for a party, hiring a taxi for a group — calling for special treatment."[233]

In certain cases the buyer may be entitled to recover damages for losses suffered by a third party. In *woodar,* Lord Wilberforce did not go beyond stating examples of cases where the plaintiff may recover damages for losses suffered by a third party. His Lordship did not state a general guideline that can be relied on to decide whether a case falls under the category of cases where the plaintiff can recover for losses suffered by a third party. However, one may argue that there is another line of cases in English law which may be relied on to argue that the buyer should be entitled, in principle, to recover for losses suffered by a third party beneficiary.[234] The damages recovered should be held by the buyer for the third party who suffered the loss.[235]

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[230] This rule was stated by the House of Lords in *Woodar Investment Development Ltd. v. Wimpey Construction Co. Ltd.* [1980] 1 WLR 277.
[231] [1975] 1 WLR 1468.
[232] [1980] 1 WLR 277.
[233] Ibid, p.283.
[234] This issue is beyond the scope of the 1999 Act.
[235] In general, where a person recovers damages for losses suffered by a third party, such damages must be held for that other person. See A.G. Guest, supra 17 at para.19-063 citing *Albacruz (Cargo Owners) v. Albazero (Owners) (The Albazero)* [1977] AC 774, 842.

Exceptionally, the promisee may recover for losses suffered by a third party. This exception to the general rule of privity was recognized by the English Court as early as 1839 in *Dunlop v. Lambert.*[236] In this case, where the goods were damaged, the shipper was allowed to bring an action in contract against the shipowner although the shipper had no proprietary interest in the goods at the time when the goods were damaged. The rule of *Dunlop* was well explained in *Albacruz (Cargo Owners) v. Albazero (Owners) (The Albazero).*[237] In this case, Lord Diplock said

> "[t]he only way in which I find it possible to rationalise the rule in *Dunlop v Lambert* so that it may fit into the pattern of the English law is to treat it as an application of the principle... *that in a commercial contract concerning goods where it is in the contemplation of the parties that the proprietary interests in the goods may be transferred from one owner to another after the contract has been entered into and before the breach which causes loss or damage to the goods, an original party to the contract, if such be the intention of them both, is to be treated in law as having entered into the contract for the benefit of all persons who have or may acquire an interest in the goods before they are lost or damaged, and is entitled to recover by way of damages for breach of contract the actual loss sustained by those for whose benefit the contract is entered into.*"[238] [Emphasis added].

It seems clear, from the words of Lord Diplock, that the party to a contract may bring a contract action against the other party for losses suffered by a third party beneficiary where it was in the contemplation of both parties that the proprietary interest in the goods will be transferred to the third party. At first sight, one may conclude that such an exception may apply to sale of goods cases. However, a close look to the dictum of Lord Diplock shows that sale of goods cases may not fit here. Lord Diplock requires, for such an exception to apply, that the proprietary interest in the goods passes to the third party after making the contract and before the breach. In *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.,*[239] the rule of *Dunlop* was applied to aconstruction contract.[240]

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[236] [1839] 6 Cl & F 600; 7 ER 824.

[237] [1977] AC 774.

[238] *Albacruz (Cargo Owners) v. Albazero (Owners) (The Albazero)* [1977] AC 774, 847. Cited in *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.* [1994] 1 AC 85.

[239] [1994] 1 AC 85. In this case, the House of Lords dealt with two appeals, i.e. *Linden Gardens Trust Ltd. v. Lenesta Sludge Disposals Ltd. and others* and *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.*, which had similar issues. This chapter is concerned with the second appeal.

[240] In *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.*, [1994] 1 AC 85, a building contractor (Sir Robert McAlpine Ltd.) contracted with the first plaintiff (St. Martin's Property Corporation) to develop a site owned by the first plaintiff under a contract which prohibited assignment without the written consent of the contractor. The first plaintiff assigned the benefit of the contract to the second plaintiff (St. Martin's Property Investments) without seeking the consent of the contractor. The construction appeared defective and the plaintiffs sued the contractors for the cost of cure. The House of Lords held that the assignment was ineffective since it was prohibited without the contractor's consent which was neither sought nor given. This holding was fatal to the second plaintiff's claim. However, the

However, in *St. Martin's Property* the contractors breached their contract after the plaintiff had parted with its interest in the property.[241] In cases of sale of goods, the seller could be held in breach of warranty if the goods were defective at the time of delivery regardless of whether the defect was discovered at the time of delivery or at a later time. In this sense, the proprietary interest in the goods may pass to the third party beneficiary after the breach.

It is clear now that the application of the *Dunlop* rule is subject to the condition that the proprietary interest in the goods passes to the third party by the time of breach. The purpose of this condition is obviously that the promisee will suffer no loss resulting from the breach and, thus, he will not be entitled to recover more than nominal damages. Therefore, as an exception to the general rule that the party can recover only for his loss, the promisee should be allowed to recover for the loss suffered by a third party who has no cause of action against the promisor. However, in *St. Martin's Property*, the House of Lords did not discuss such a condition and was more concerned with the fact that the third party had no cause of action to recover for the loss caused by the promisor's breach.[242]

Nevertheless, the aforementioned purpose of such a condition, i.e. the condition of passing the proprietary interest in the goods by the time of breach, can be available in cases of sale of goods. It is true that the seller will be in breach of warranty as soon as he delivers defective goods. However, in certain cases the defect of the goods cannot be discovered until the goods are put to their use by the third party beneficiary. Here, the loss will be suffered by the third party who may have no cause of action against the seller. The question here is whether the buyer can recover damages from the seller for the loss suffered by the third party beneficiary. In view of the decision in *St. Martin's Property* and the rule of *Dunlop,* the question can be answered in the affirmative in

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House of Lords held that the first plaintiff was entitled to damages for losses suffered by the second plaintiff.

[241] In *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.*, [1994] 1 AC 85 Lord Griffiths, at p.96, approached the issue differently. Lord Griffiths allowed the first plaintiff for the loss suffered by the assignee on the ground that the first plaintiff was liable for the assignee to cure the defects resulting from the breach of the defendant.

[242] In *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.* [1994] 1 AC 85, Lord Browne-Wilkinson, at p.115, restricted the application of the rule of *Dunlop* to cases where the third party does not have a cause of action against the promisor. Therefore, the rule of *Dunlop* may not apply to goods consigned under a bill of lading since the property of the goods and the cause of action for damage pass to the consignee.

cases where it was in the reasonable contemplation of the parties, at the time of making the contract, that the proprietary interest in the goods would be transferred to a third party beneficiary. Where it was in the contemplation of the parties, at the time of making the contract, that the proprietary interest in the goods will be transferred to a third party, it is submitted that the rule of *Dunlop* should apply to allow the buyer to claim damages from the seller for the losses suffered by the third party as a result of the breach. Indeed, as Professor Beale questions "why should it matter whether the transfer is contemplated as taking place before or after the breach - or indeed , whether there is any transfer at all?"[243] Anyhow, if the buyer recovers damages for losses suffered by a third party, the recovered damages must be held by the buyer for the third party.[244]

Here, it should be noted that the buyer should not be entitled to bring such a claim where the third party has a cause of action against the seller or the buyer himself. In *St. Martin's Property*, Lord Browne-Wilkinson pointed out that "[t]he [promisee] will not be entitled to recover damages for loss suffered by others who can themselves sue for such loss."[245] Therefore, where the third party can bring a contract action against the seller under the 1999 Act for breach of warranty of quality, the buyer may not be entitled to claim damages from the seller for the losses suffered by the third party due to breach of warranty of quality.[246] In the Report on which the 1999 Act is based, the Law Commission states that "[w]e... do not think that there is a risk of double liability where the promisee recovers the third party's loss under one of the exceptions to the standard rule that the promisee is entitled to damages for its own loss only. Our understanding of the relevant law is that, in that situation, the third party could not subsequently recover substantial damages from the promisor under our proposal."[247] In this sense, it seems difficult to understand how Section 5(a) of the 1999 Act applies in such a case. Under this Section, the court shall reduce the third party's damages "to such extent as it thinks appropriate to take account of the sum recovered by the promisee"[248] for the loss

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[243] Hugh Beale, "Privity of Contract: Judicial and Legislative Reform", (1995) 9 *JCL* 103, 107.
[244] A.G. Guest, supra n.17 at para.19-063 citing *Albacruz (Cargo Owners) v. Albazero (Owners) (The Albazero)* [1977] AC 774, 842.
[245] *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.* [1994] 1 AC 85, 115. See also G.H. Treitel, 'Damages in Respect of a Third Party's Loss' (1998) 114 *LQR* 527, 528.
[246] Andrew Burrows, 'Reforming Privity of Contract: Law Commission Report No.242' [1996] *LMCLQ* 467, 479.
[247] Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. No.242, para.11.17.
[248] Section 5(1) of the 1999 Act states "Where under section 1 a term of a contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of- (a) the third party's loss in respect of the term, or (b) the expense to the promisee of making good to the third party the default

suffered by the third party. Clearly, the Section presumes that the promisee may have a contract action against the promisor for losses suffered by a third party in cases where the third party can bring an action against the promisor under the 1999 Act. It seems that such a presumption is in direct contradiction with the aforementioned words of Lord Browne-Wilkinson which disallow the promisee to sue the promisor for losses suffered by a third party in cases where the third party has a cause of action. However, Section 5 of the 1999 Act provides help in cases where the buyer recovers damages from the seller for expenses incurred in curing the defective goods transferred to the third party or compensation paid to the third party. In such cases, the court shall reduce the third party's damages, recovered from the original seller, by the amount awarded to the buyer.[249]

To sum up, the 1999 Act may apply to relax the rigour of horizontal privity. However, due to the requirement of express identification, the 1999 Act may not apply in most cases where the goods are bought for a third party beneficiary. Nevertheless, where the circumstances of the case, such as the nature of the goods, make it reasonable for the seller to know that the goods are bought for a third party beneficiary, the court, it is submitted, should go beyond the scope of the 1999 Act to allow the third party's claim even though such a party was not expressly identified at the time of making the contract. The Law Commission Report on which the 1999 Act is based makes it clear that the court may offer consumers better protection in cases where it decides that the 1999 Act does not go far enough. Furthermore, it was argued that there is nothing to prevent the court allowing the buyer to recover damages for the loss suffered by the third party's beneficiary who can bring an action against neither the buyer nor the seller. Such exception to the doctrine of privity has not been abolished by the 1999 Act.

In addition, a beneficiary other than the ultimate buyer may not be entitled to bring a contract action against the remote seller. However, as previously argued, the privity doctrine should be relaxed in order to prevent the remote seller escaping liability for defective goods. Where a husband buys goods for his wife, the wife should be able to sue the manufacturer if the goods appear defective. It was submitted above that the

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of the promisor, then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum recovered by the promisee."

[249] Ibid.

ultimate buyer should have a direct action against the remote seller for defective goods. If this submission is ever accepted, there will be no reason why a beneficiary other than the ultimate buyer cannot bring such an action against the manufacturer. Suppose, for example, that a father has bought goods for his daughter. If the father has a cause of action against the manufacturer, he will not be able to recover more than nominal damages since he did not suffer loss. Therefore, the daughter should be able to bring an action against the manufacturer. Chris Willet points out that "the central rationale for the reform is that it is reasonable for consumers to expect that those who make goods will be responsible for their quality. This would not seem to alter by virtue of the fact that the consumer is not original purchaser."[250] It is submitted that third party beneficiary should be entitled to bring an action against the remote seller for losses resulting from the defective quality of goods.

6.2.2 Extended Warranty under the UCC

Section 2-318 of the UCC extends warranties to beneficiaries, other than the buyer.[251] The Section includes three alternatives of extension. The alternatives vary in respect of the definition of beneficiaries and the kinds of loss suffered. It has been left to the States to choose one of these alternatives.[252] It is worth noting that the Section is not intended to restrict the extension of warranty under the American case law.[253] In fact, many courts have extended warranties to more than those specified by the adopted alternatives of Section 2-318.[254]

The alternatives provided by Section 2-318 have to be examined in order to identify the beneficiaries who can benefit from the Section. The Section provides

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[250] Chris Willett, "The Quality of Goods and the Rights of Consumers" (1993) 44 *NILQ* 218, 226.

[251] The non-UCC rules regarding third party beneficiary should continue to apply as long as they are not displaced by Section 2-318. So if the seller and the buyer intended to give the benefits of the warranty to a subsequent transferee, the latter has the rights created by such a warranty. See TD Crandall, MJ Herbert and L. Lawrence, supra n.70 at p.7:75.

[252] Originally, Section 2-318 of the UCC did not provide alternative. In 1966 the Permanent Editorial Board (PEB) of the UCC amended the Section by adding two alternatives. The original 2-318 has been kept as alternative A.

[253] Comment 3 to Section 2-318 provides that "[t]he first alternative expressly includes as beneficiaries within its provisions the family, household and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain."

[254] See J.E. Murray, Jr., 'Products Liability v. Warranty Claims: Untangling the Web' (1983) 3 *J. L. & Com.* 269, 276; W.D. Hawkland, *Hawkland UCC Series* §2-318—Article 2, 1988, p.2.789.

"**Alternative A**[255]

A seller's warranty whether express or implied extends to any natural person who *is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty*. A seller may not exclude or limit the operation of this section.

Alternative B[256]

A seller's warranty whether express or implied extends to any natural person *who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty*. A seller may not exclude or limit the operation of this section.

Alternative C[257]

A seller's warranty whether express or implied extends to any person *who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty*. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends." [Emphasis added]

The alternatives[258] are mostly concerned with personal injury[259] suffered by natural beneficiaries[260] as a result of breach of warranty. The purpose of such alternatives is probably to equalize the positions of the ultimate buyer and other beneficiaries. Where the ultimate buyer suffers personal injury due to the breach of warranty, he can claim damages in a contract action from his direct seller.[261] By extending the seller's warranty to other beneficiaries, they will have the same legal position of the buyer regarding breach of warranty express or implied.

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[255] Alternative A has been adopted by the following states: New Mexico, Kentucky, Arkansas, Connecticut, District of Columbia, Florida, Georgia, Idaho, Illinois, Arizona, Indiana, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, Alaska, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Tennessee, Washington, West Virginia and Wisconsin.

[256] Alternative B has been adopted by the following states: Alabama, Colorado, New York, Delaware, Kansas, South Carolina, Vermont and the Territory of the Virgin Islands.

[257] Alternative C has been adopted by the following states: Hawaii, Iowa, Minnesota, North Dakota, Utah and Wyoming.

[258] Texas has not adopted any of the alternatives. It left the matter of privity to be decided under the case law. In Texas, the requirement of privity in cases of physical losses has been abolished. See here J.S. Allee, *Product Liability,* New York, 1995, p.5.8. Illinois, has not adopted either of the alternatives but retains its original codification of Section 2-318 which became alternative A after 1966.

[259] See *Johnson v. General Motors Corp.*, 349 Pa. Super. 147; 42 UCC Rep. Serv. 851 (1986).

[260] See *General Motors Corp. v. Halco Instruments, Inc.*, 124 Ga. App. 630; 9 UCC Rep. Serv. 1193 (1971).

Under alternative C, beneficiaries who may reasonably be expected to use, consume or be affected by the goods, can claim for losses, whether economic or physical, suffered by the breach of the extended warranty.[262] Unfortunately, alternative C was adopted by few States.[263] The reason why the other alternatives extend warranty to cover only personal injury is not clear. Perhaps the drafters of the UCC expected that some states would be in favour of keeping the requirement of privity in cases of economic loss.

In fact, the words of Alternative C allow the beneficiary to bring an action in contract against the seller for any economic or physical loss suffered.[264] Therefore, such a beneficiary may sue the seller for damages for the diminution of value resulting from breach of warranty of quality. He may also sue him for consequential loss of profit. Suppose that a person hires a profit-making machine from the buyer. Suppose further that the hirer suffered loss of profit due to the defective quality of the machine. Under Alternative C, the hirer may sue the seller for his loss of profit, if it was expected at the time of purchasing the machine that the hirer would use it.

The main issue here is whether the Section 2-318 affects vertical privity. In other words, can implied or express warranty, issued to a direct buyer, extend to a sub-buyer? Suppose that (W) issued an express warranty to his direct buyer (X) who resold the goods to (Y). If (Y) suffered loss due to the breach of such express warranty, could he claim that W's warranty was extended to him under Section 2-318? Obviously, alternative A does not allow the ultimate buyer to bring such a suit since it extends the warranty, whether implied or express, only to natural persons who are in the family or household of the buyer or who is a guest in his home. The ultimate buyer is not one of these beneficiaries. Under alternatives B & C, W's warranty may extend to (Y) and other beneficiaries if they were reasonably expected to use, consume or be affected by the goods.[265] For example, in *Dalton v. Stanley Solar & Stove, Inc.,*[266] it was held that

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[261] See J.W. Wade, Tort Liability for Products causing Physical Injury and Article 2 of the UCC (1983) 48 *Mo. L. Rev.* 1, 7.

[262] C.R. Reitz, supra n.174 at p.369.

[263] Ibid at n.42.

[264] See W.L. Stallworth, 'An Analysis of Warranty Claims Instituted by Non-Privity Plaintiffs in Jurisdictions that have Adopted Uniform Commercial Code Section 2-318 (Alternatives B & C)' (1993) 27 *Akron L. Rev.* 197.

[265] W.L. Stallworth, 'An Analysis of Warranty Claims Instituted by Non-Privity Plaintiffs in Jurisdictions that have Adopted Uniform Commercial Code Section 2-318 (Alternative A)' (1993) 20 *Pepp. L. Rev.* 1215, 1233. In Alabama, the UCC was enacted with some modifications regarding the extension of warranties. Under these modifications, the Alabama's law extends manufacturers' warranties to the

no privity was required under alternative C for suit by an ultimate consumer against the manufacturer of a wood stove.

The draft of revised Article 2 of the UCC[267] does not add much to this Section. Section 2-318 of the Draft differs from the current 2-318 in that it makes it clear that express warranty issued by the remote seller to the ultimate buyer can extend to other beneficiaries as provided under the Alternatives of Section 2-318. The change in the Section is due to the new provisions of 2-313A which deals with warranties accompanying or packaged with the goods and 2-313B which deals with warranties communicated to the public as explained above.[268] When the Draft comes into force, the enforceability of such warranties will become beyond question.

6.2.3 Extended warranty under the CISG

The CISG does not deal with the issue of the extension of warranty to beneficiaries other than the buyer. Extension of warranty, under domestic laws, is normally intended to protect beneficiaries who are in a relationship with the consumer, such as the case of the American UCC. The CISG does not apply where the goods are purchased for

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ultimate consumers who might reasonably be expected to use or be affected by their goods. See *Atkins v. American Motors Corp.* 335 So.2d 134 (Ala. 1976).

[266] 629 A.2d 794 (N.H. 1993).

[267] The draft of March 2000. Section 2-318 of the Draft states

(a) In this section: (1) "Immediate buyer" means a buyer that has a contract with the seller. (2) "Remote purchaser" means a person that buys or leases from an immediate buyer or other person in the normal chain of distribution.

Alternative A to Subsection (b)

A seller's warranty whether express or implied to an immediate buyer, a seller's remedial promise to an immediate buyer, or a seller's obligation under Section 2-313A or Section 2-313B to a remote purchaser extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Alternative B to Subsection (b)

A seller's warranty whether express or implied to an immediate buyer, a seller's remedial promise to an immediate buyer, or a seller's obligation under Section 2-313A or Section 2-313B to a remote purchaser extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

Alternative C to Subsection (b)

A seller's warranty whether express or implied to an immediate buyer, a seller's remedial promise to an immediate buyer, or a seller's obligation under Section 2-313A or Section 2-313B to a remote purchaser extends to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends."

[268] Supra, p.249.

personal, family or household use.[269] It seems that it was the intention of the drafters to exclude consumer sales from the scope of the Convention due to the wide variations, in this field, among the several countries.

The CISG does not apply to claims brought by third parties. However, as previously mentioned, the participation of the seller in the ultimate purchase contract may furnish a ground for a collateral relationship between such a seller and the ultimate buyer.[270] Furthermore, as the CISG does not foreclose claims arising under domestic laws in areas out of its scope, extended warranty may apply under the applicable domestic law.[271] For example, suppose an American consumer bought goods from an American distributor who purchased such goods from a French manufacturer. Suppose further that the American consumer suffered physical losses due to the use of such goods. In such an example, subject to the applicability of the American law under the private international law, the American consumer may sue the French seller under Section 2-318 of the UCC. Anyhow, this situation seldom happens since the ultimate buyer normally sues the direct seller who can bring his seller to defend the ultimate buyer's action.

Conclusions

Under current English law, the ultimate buyer cannot bring a contract action against the remote seller. However, in cases of string contracts, liability may pass from a seller to another until it reaches the original seller. If this becomes the case, one may wonder why the ultimate buyer cannot bring a direct contract action against the remote seller. In fact, the method of 'passing up the liability' may be inapplicable where the chain is broken. This can be the case where a party in the chain has disappeared or become insolvent or where a party in the chain shelters behind disclaimer clauses. In cases such as *Lambert and another v. Lewis and others*,[272] the chain may be practically broken since the commercial buyer cannot identify his immediate seller of the goods. In this sense, manufacturers may escape liability and ultimate buyers may be left without remedy. Even where the ultimate buyer recovers damages from the retailer, the retailer may not always be able to pass the liability up the chain so that it reaches the manufacturer. It

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[269] Article 2 of the CISG states "This Convention does not apply to sales: (a) of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use..."
[270] Supra, p.257.
[271] R.E. Speidel, supra n.206 at p.185.
[272] [1982] AC 225.

seems unfair to hold the retailer liable for losses caused by defective manufacturing and at the same allow the manufacturer to escape liability for such a defect.

The Contracts (Rights of Third Parties) Act 1999 is unlikely to provide help in cases of string contracts. It is true that in theory the 1999 Act will apply to sale of goods cases if the parties to the sale contract agree *expressly* to confer a legal right on the sub-buyer; in practice, such *express* agreement can hardly be found. The Law Commission Report on which the 1999 Act is based makes it clear that in the absence of such an express agreement the 1999 Act does not apply even though the contract is intended to confer a benefit on the sub-buyer who is expressly identified. Therefore, although the 1999 Act seems to provide help in cases of horizontal privity, it is unlikely to apply to cases of string contracts.

However, it was argued that the 1999 Act does not go far enough to protect the ultimate buyer, especially in cases where such a buyer cannot sue his immediate seller for practical reasons such as the disappearance or the insolvency of the seller. In fact, the Law Commission makes it clear that the court may go farther than the 1999 Act where it decides that the Act does not go far enough to protect the third party. Indeed, some legal writers, such as Adams and Brownsword, argue that the 1999 Act does not go far enough to relax the privity requirement in cases of string contracts. Therefore, the court, it is submitted, should allow the ultimate buyer to bring a direct contract action against the remote seller for foreseeable losses resulting from defective goods, especially in cases where the retailer has disappeared or become insolvent. If this submission is accepted, the remote seller should be able to rely on the terms of his contract with his immediate buyer. In tort, this was decided by Robert Goff LJ in *Muirhead v. Industrial Tank Specialities Ltd. and Others.*[273] However, the remote seller should not be able to exclude his liability for defective goods where the plaintiff is consumer. Moreover, Professor Beale argues that the manufacturer should be required to repair or replace the defective goods or refund the price to the ultimate buyer. However, the reasoning of Professor Beale may not apply to all cases. Therefore, the remote seller should be liable for all foreseeable losses suffered by the ultimate buyer. Of course, the recovery of damages is always subject to the normal restrictions, i.e. causation, remoteness, certainty and mitigation.

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[273] [1986] 1 QB 507.

Under the current text of the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, consumers cannot sue producers in contract for losses caused by the defective quality of goods. However, the Directive will be reviewed in relation to the producer's liability. By making the producers directly liable for defective goods, they will have an adequate incentive to produce their goods carefully. The Directive does not provide for the remedy of damages for defective quality. It is submitted that the consumer should be offered the choice to sue under the EC Directive or the SGA so that he can recover for his consequential losses caused by the defective goods.

The EC Directive provides for the enforceability of producers' guarantee to reimburse the price paid or to replace, repair or handle consumer goods in any way. However, the Directive does not provide for the producer's liability for breach of his public statement regarding the quality of his products. Under the Directive, such statements are considered in assessing the liability of the retailer. Although this may provide better protection to consumers, it seems to be unfair for retailers especially in cases where the producer makes such statements after the time that the retailer purchases the goods or where it was not reasonable for the retailer to be aware of such statements at the time he purchases the goods from the producer or distributor. Hopefully, the Directive after its review will provide that the producer is bound by his statement.

Where the producer's or any remote seller's public statement induces the ultimate buyer to purchase certain goods, there may be a collateral contract. The ultimate buyer's purchase may be interpreted as a reciprocal action to the remote seller's warranty. However, such a contractual relationship is hard to be found in cases of warranty accompanying or packaged with the goods. In such cases, it is likely that the buyer will not become aware of the warranty until he purchases the goods. Nowadays, manufacturers make intensive use of advertisements to induce ultimate buyers to purchase their products. In such a case, it is highly unrealistic to limit purchaser's protection to warranties made directly to him under the retail contract. Certainly, the policy of protecting ultimate buyers in cases of such warranty outweighs reliance on the requirement of privity.

As regards horizontal privity, it seems that such privity has been relaxed by the 1999 Act. The Law Commission Report on which the 1999 Act is based makes it clear that where the goods are bought for a third party who is *expressly* identified, the third party beneficiary can sue the seller in contract unless the parties did not intend to confer a legal right on the third party. However, it was argued that the requirement of *express identification* seems to be unfair in certain cases. This can be the case where the circumstances indicate that the goods are bought for a third party. The requirement of express identification does not exist under American law. Under Section 302(1) of the American Restatement (Second) of Contracts, the parties do not need to expressly identify the third party nor do they need to include in the contract an express term of their intention.

Therefore, it is submitted that the third party beneficiary should be entitled to sue the retailer or the remote seller for losses caused by the defective quality of goods where it was reasonable for the seller to know at the time of making the contract that the goods were bought for a third party. Furthermore, it was argued that the decision of the House of Lords in *St. Martin's Property Corporation v. Sir Robert McAlpine Ltd.*[274] should be interpreted to allow the buyer to claim damages for losses suffered by the third party beneficiary *who can bring an action against neither the buyer nor the seller*.

In comparing *current* English law with American law, one may note that American law provides more protection to the ultimate buyer and other beneficiaries. Unlike English law, in all the American jurisdictions, privity is not required in cases of physical loss even where the aggrieved party brings an action in contract. Therefore, the ultimate buyer is entitled to bring an action in contract against the remote seller for physical loss caused by breach of warranty of quality. Where the ultimate buyer suffers purely economic loss, the applicability of privity varies among the several States of the USA. In certain states, the ultimate buyer can bring an action in contract against the remote seller for the diminution in value of the goods supplied. As regards remote seller's express warranties and public statements, the draft of the revised Article 2 of the UCC provides two new sections, 2-313A and 2-313B, which make the remote seller's warranty enforceable. The new sections do not require the buyer's reliance on the warranty for purchasing the goods in cases of warranty accompanying or packaged with

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[274] [1994] 1 AC 85.

the goods. However, such reliance is still required in cases of warranty made through advertising. Nevertheless, English law will soon provide better protection for consumers. Provisions for the enforceability of certain producer's guarantees can be found in the EC Directive mentioned above. Furthermore, as mentioned above, the Directive will be reviewed regarding producer's liability for defective goods. However, the Directive applies to consumer cases only.

In addition, Section 2-318 of the UCC extends warranties to third parties beneficiaries. Section 2-318 provides three alternatives for the extension of warranty. Only the third alternative allows the claim of such beneficiaries for economic loss. This seems to offer perfect protection to third party beneficiary. Such extension cannot be found under English law. However, the 1999 Act may apply in certain cases to allow third party beneficiary to sue the seller for defective goods.

At the last point, one should not fail to mention that the CISG seems to be inapplicable to third party's claim. Even where there is a collateral contract between the seller and the third party, the CISG may not apply since its application is limited to the original sale contract. In fact, this seems to be a fundamental gap in the Convention. The third party's claim will be decided under the applicable law. Furthermore, the validity of the exclusion clauses will be decided under the applicable law since the Convention is not concerned with the validity of the contract terms. In this sense, the validity of a term controlling third party's claim against the seller will be decided under the applicable domestic law. As the chain of contracts in international sales may include parties from different legal systems, this will leave the seller in an insecure position. A provision regulating third party's claim could have avoided such insecurity.

Chapter Seven

Defences to Warranty Actions

Introduction

Chapter one of this thesis mentioned that the principle of *Robinson v. Harman*[1] should be applied in conjunction with other principles concerned with the remedy of damages. Such principles can be raised by the seller in order to defend the buyer's action for damages. If the seller is successful in defending the buyer's action by raising such principles, the buyer's damages may be reduced or disallowed. One of these defences is uncertainty as to the fact and amount of loss which may be a strong defence in cases of loss of profit as discussed in chapter four. The seller may also be able to prove that the loss has not resulted from the breach of warranty of quality or that could have reasonably been avoided or that it is too remote. Furthermore, under both the UCC and the CISG, the buyer is required to notify the seller of non-conformity of goods within a reasonable time after the discovery of the breach. Therefore, the buyer's action may fail due to the absence of notification. Such a defence is not available under English law in cases where the buyer's claim is for damages. Therefore, one may need to find out whether such a notification is important in cases where the buyer brings an action for damages for breach of warranty of quality. The seller may also rely on the doctrine of privity to defend the sub-buyer's contractual action against him, as discussed in the previous chapter. Most of the seller's defences have been taken into consideration in dealing with issues raised in the previous chapters. Therefore, the examination of such defences in this research seems to be unavoidable.

There seem to be differences between the SGA, the UCC and the CISG in applying the restrictions mentioned. A comparison between the SGA, the UCC and the CISG may show the adequate way of applying such restrictions. Here, it should be noted that the purpose of this chapter is not to deal with the general application of these defences in contract law. The examination of the application of such restrictions will be mostly concerned with cases of breach of warranty of quality.

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[1] (1848) 1 Exch 850, 855. Supra, p.1.

A number of difficulties may face the application of these principles to cases of breach of warranty of quality. For example, there seems to be no coherent attitude, under the several legal systems, towards the applicability of the causation restriction to reduce the amount of damages claimed. Such a variation in the application of the causation restriction might influence the applicability of the restriction under the CISG. This might also be the case of the defence of lack of notification under the UCC and the CISG. The time and content of such a notification varies among the several legal systems.

There are also a number of slight differences between the SGA, the UCC and the CISG regarding the application of the mitigation and remoteness principles. This chapter will make a comparison between the SGA, the UCC and the CISG in order to deal with such differences. In applying such principles in cases of breach of warranty of quality, certain issues need to be dealt with. For example, is the buyer required, under the mitigation principle, to stop using defective goods after he becomes aware of the defect? Does the mitigation principle require the buyer to accept the seller's offer to repair or replace defective goods or restore the contract price and take the goods back? Furthermore, under the remoteness principle, some points are approached differently under English law, the UCC and the CISG. Such laws seem to disagree on whether the test of remoteness is objective or subjective neither do they agree on whether the principle applies to the kind or the amount of loss.

7.1 Causation

Under the SGA, the UCC and the CISG, the restriction of causation, as one of the restrictions imposed on the recovery of damages, requires a sufficient causal link between the seller's breach and the buyer's loss. It seems essential for the buyer to show such a causal link even in cases where the loss was or should have been in the reasonable contemplation of the seller at the time of making the contract. For example, in the UCC case of *Overstreet v. Norden Laboratories, Inc.*,[2] where the buyer presented an ample evidence that the loss was reasonably foreseeable at the time of making the contract, the Court held that the loss was not totally caused by the breach of warranty of quality and, hence, the recovery was denied regardless of whether the loss was

[2] 1982 U.S. App. LEXIS 22121; 33 UCC Rep. Serv. 174 (6th Cir. 1982).

foreseeable. However, where the intervening event was expected by the parties at the time of making the contract, the seller may not be excused from liability on the ground that such an event cooperated with his breach to bring about the loss.[3]

7.1.1 Aspects of the Restriction under the SGA and the UCC

The restriction of causation seems to have similar application under both English and American law in most cases. However, English and American law seem to disagree on whether contributory negligence can reduce damages in cases of defective goods, as discussed under the following section. In general, actions that may break the causal link, in cases of breach of warranty of quality, seem difficult to be put in an exhaustive list. Deciding whether or not the loss is caused by the breach, is a matter of fact which depends on the circumstances of each case.[4] In certain cases, the application of the principle is straightforward. For example, the buyer will not be entitled to recover the compensation paid to sub-buyers for losses not caused by the seller's breach.[5] In other cases, the application of the principle needs special care, such as the case of misuse of products. Here, the general rule is that the buyer is not entitled to damages for losses caused by his misuse of the goods purchased.[6] However, where the court finds that the misuse did not contribute significantly to the loss resulting from the breach of warranty of quality, the seller may be held liable for the whole loss.[7]

More significant, regarding the application of the causation restriction, is the case where the loss results from the use of defective goods without pre-examination. In this respect, comment 5 to Section 2-715 of the UCC provides that where the loss results from "the

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[3] R.R. Anderson, 'Incidental and Consequential Damages' (1987) 7 *J. L. & Com.* 327, 371; A.G.Guest, *Benjamin's Sale of Goods,* London, 5th ed., 1997, para.16-046.

[4] See the UCC case of *Chatfield v. Sherman-Williams Co.*, 1978 Minn. LEXIS 1323; 24 UCC Rep. Serv. 285 (1978).

[5] H.L.A. Hart and T. Honoré, *Causation in the Law,* Oxford, 2nd ed., 1985, 311. The buyer will not be entitled to recover, as damages, expenses which are attributable to the his fault or which may be incurred whether the seller breached his warranty or not. See here the UCC case of *Barnard v. Compugraphic Corp.,* 37 UCC Rep. Serv. 141 (1983) where the Court held that the buyer was not entitled to recover, as damages, the interest paid for financing the purchase price of a typewriter since such interests would have been paid whether the seller breached his warranty or not. See also *Cundy v. International Trencher Service, Inc.*, 39 UCC Rep. Serv. 1278 (1984).

[6] See the UCC cases of *Wenner v. Gulf Oil Corp.* 1978 Minn. LEXIS 1361; 23 UCC Rep. Serv. 603 (1978), *Elanco Prods. Co. v. Akin Tunnell,* 1971 Tex. App. LEXIS 2300; 10 UCC Rep. Serv. 30 (1971).

[7] See the UCC cases of *Mann v. Weyerhaeuser Co.*, 1983 U.S. App. LEXIS 29643; 35 UCC Rep. Serv. 1147 (8th Cir. 1983). See also *Southern Illinois Stone Co. v. Universal Engineering Corp.* 1979 U.S. App. LEXIS 23612; 38 UCC Rep. Serv. 858 (8th Cir. 1979) where the Court held that the misuse of a rock crushing equipment, by setting off small dynamite charges in the mouth of the crusher to clear rock jams, does not bar the recovery as long as the principal cause of the buyer's loss is the improper design.

use of goods without discovery of the defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty." The comment states that the causal link may not be established where the loss results from the use of goods which appeared defective before using them. In fact, the buyer, in continuing to use the defective goods after the discovery of the defect, will increase his loss which he could reasonably have avoided or mitigated by repairing the defective goods or simply by stopping using them. Therefore, the mitigation principle can be an appropriate reason for the buyer's disallowance of damages for losses resulting from continuing to use defective goods.[8]

Under both the SGA and the UCC, the examination of goods is a right of the buyer and not a duty.[9] However, in certain cases, e.g. where it is unreasonable for the buyer to use the goods without inspection, the causal link between the breach and the loss may be broken by the buyer's negligence to investigate the goods. However, in normal circumstances, the buyer is entitled to sue the seller for losses due to defective goods regardless of whether the defect could have been discovered by a reasonable examination. The case of *Beoco Ltd v. Alfa Laval Co. Ltd.*,[10] seems to be helpful here. In this case, the seller, who was the first defendant, installed a heat exchanger at the plaintiff company's premises. The heat exchanger appeared defective and the plaintiff employed the second defendant to repair it. The repair was defective. Without first carrying out any inspection of the repair, which would have revealed the defect of the repair, the plaintiff put the heat exchanger back into use. The heat exchanger exploded

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[8] The comment has misled the court in many cases. See for example *Erdman v. Johnson Bros. Radio & Television Co., Inc.*, 1970 Md. LEXIS 755; 8 UCC Rep. Serv. 656 (1970) where it was held that a purchaser who uses obviously defective goods cannot recover for consequential losses since his conduct is the intervening cause of the loss. It is submitted that mitigation would be a more appropriate principle for the decision. See also *Bemidji Sales Barn, Inc. v. Chatfield*, 20 UCC Rep. Serv. 1137 (1977).

[9] Section 34 of the SGA states "Unless otherwise agreed when the seller tenders delivery of goods to the buyer, he is bound on request to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract and, in the case of a contract for sale by sample, of comparing the bulk with the sample."
Section 2-513(1) of the UCC provides "... where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner...". In some UCC cases the court held that examination is not a duty. See the UCC case of *Taylor & Gaskin v. Chris-Craft Industries*, 1984 U.S. App. LEXIS 23612; 38 UCC Rep. Serv. 858 (6th Cir. 1984) where the Court held that the buyer's failure to undertake corrosion tests was not blameworthy and cannot be a successful defence for a buyer's action of warranty of quality. See also the UCC case of *Upjohn Co. v. Rachelle Laboratories, Inc.*, 1981 U.S. App. LEXIS 16698; 32 UCC Rep. Serv. 474 (6th Cir. 1981).

and caused damage to the plaintiff's property. The plaintiff sued the seller for the cost of repair of the defective heat exchange and loss of profit resulting from the loss of production while the repair was being effected. Furthermore, the plaintiff sought to recover for loss of profit on lost production during the time which would have been taken to make good the defective repair had the exchanger not been put back into service and exploded. The Court of Appeal awarded the plaintiff damages for the cost of repair and loss of profit for the period of time within which the exchanger was being repaired. However, it refused to allow the plaintiff further damages on the ground that any further repair required had been subsumed in the more extensive repairs required as the result of the explosion. The Court held that the explosion had been the result of the plaintiff's own negligence of not inspecting the exchanger before putting it into service.

Some commentators[11] have submitted that the decision in *Beoco* can be reached under the principle of mitigation. This is due to the fact that it was reasonable for the buyer to mitigate his loss by examining the repair of the machine before putting it to use. The loss, therefore, was reasonably avoidable. In fact, one may find that the restrictions of causation, mitigation and remoteness may overlap in a case such as *Beoco.* However, this does not seem to affect the actual decision of the court. One here may suggest that the decision in *Beoco* could also have been reached under the remoteness principle.[12] It is quite understandable that it should have been in the reasonable contemplation of the parties, at the time of making the contract, that the machine would be repaired or replaced if it appeared defective. But, it might not be reasonable for the parties to contemplate that the substitute goods or the repair would be defective. If this becomes the case, the buyer may not be entitled to recover for losses resulting from defective replacement or repair since such losses are remote. A supportive opinion can be found in the UCC case of *Falcon Tankers, Inc. v. Litton Systems, Inc.,*[13] where the buyer had purchased substitute goods in order to replace the defective contracted goods. The substitute goods appeared defective and, as a result of their use, the buyer suffered consequential losses. In this case, the Court absolved the original seller of liability for the consequential losses, resulting from the use of the defective substitute, on the ground

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[10] [1995] QB 137.
[11] A.G. Guest, *Chitty on Contracts*, London, Vol. 1, 28th ed., 1999, para. 27-029; A.G. Guest, supra n.3 at para.16-046, n.66.
[12] Infra, p.284.
[13] 19 UCC Rep. Serv. 434 (1976).

that it was not reasonable for the buyer to foresee, at the time of making the contract, that the replacement goods would be defective.

7.1.2 Causation under Article 74 of the CISG

Article 74 of the CISG allows damages for losses resulting from breach of contract. Naturally, the causation restriction applies, under the Convention, to disallow the buyer to recover for losses which are not causally connected with the breach of the seller's warranty of quality. Under the Convention, the application of the causation restriction is not as easy as it seems. Due to the difference in the application of the causation restriction among the various legal systems, as explained below, the application of the causation restriction under the Convention may be influenced by domestic laws and, as a result, varies among the different countries.

Under English law, the loss would be causally linked to the breach if it would not have occurred *but for* the breach.[14] Where there are multiple causes of the loss, the court has to find out whether the breach was sufficient to cause the loss. Therefore, the buyer may be entitled to damages where the breach of warranty of quality is one of two causes which are of equal efficacy and combined to bring about the loss.[15] The Law Reform (Contributory Negligence) Act 1945 (henceforth the CNA) permits apportionment of loss by the reduction of the buyer's damages where he "suffers damages as the result partly of his own fault and partly of the fault of any other person."[16] Here, it should be noted that the CNA applies only to cases where the defendant is liable in tort or where he is co-extensively liable in tort and contract.[17] The CNA seems to have no application to cases where the broken contractual duty is strict.[18] It should be clear that the seller's liability under the SGA for defective goods is strict.[19]

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[14] J. Swanton and B. McDonald, Common Law: Proof of Causation in Claims for Negligence and Breach of Contract, (1999) 73 *Austl. L. J.* 23.
[15] See *Heskell v. Continental Express Ltd.* [1950] All ER 1033,1048.
[16] Section 1(1) of the Law Reform (Contributory Negligence) Act 1945.
[17] See here Law Commission, *Contributory Negligence as a Defence in Contract,* Law Com. No.219. See also Anderson, 'Contributory Negligence in Contract—Again' [1987] *LMCLQ* 10; Burrows, 'Contributory Negligence in Contract: Ammunition for the Law Commission' (1993) 109 *LQR* 175.
[18] *Barclays Bank v. Fairclough Building Ltd.* [1995] 1 All ER 289. See Michael Furmston, *Cheshire, Fifoot & Furmston's Law of Contract,* London, 1996, p.634.
[19] See Michael Furmston (ed.), *The Law of Contract,* London, 1999, p.1279.

A comparison between English law and American law may show that the latter is more favourable for the seller since it allows damages to be reduced under the defence of contributory negligence for losses resulting from defective goods. Indeed, under American law, comparative negligence can be a defence to warranty action.[20] Under the defence of comparative negligence, liability is to be apportioned between the seller and the buyer according to their respective percentages of causation.[21] In other words, under such a defence, the court apportions loss among various causes in order to charge the seller for that percentage of the loss attributable to his respective wrong.

It is submitted that contributory negligence should be considered to reduce the buyer's damages for losses resulting from defective quality of goods. If the buyer's action is not enough to break the causal link, there seems to be no reason why should not such an action be considered to reduce the buyer's damages. Therefore, the position in American law regarding this point is better than the position in English law. Under English law, the buyer's damages for defective goods cannot be reduced by an amount, in proportion to the degree to which his fault contributed to the loss.[22] Therefore, in this case, the seller may be totally liable for losses resulting from his breach of warranty of quality if such a breach is sufficient enough to bring about the loss. On the other hand, if such a breach is not sufficient enough to cause the loss, the seller may be held not liable. However, this does not seem the case under French law. Under French law, the causation restriction can be applied to reduce damages in all kinds of case.[23] Suppose hypothetically that the buyer suffered loss of production of a machine due to its breakdown. Suppose further, that the breakdown was caused partly by the buyer's improper use of the machine and partly by a defect in its quality. In this case, if the buyer claimed damages for his loss of production, the causation restriction would likely apply in England and France differently. The causation restriction in England would not affect the amount of damages. Under both French and English law, if the sole cause of

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[20] See the UCC case of *Karl v. Bryant Air Conditioning Co.* U.S. App. LEXIS 28852; 35 UCC Rep. Serv. 1494 (6th Cir. 1983).

[21] See the UCC case of *Signal Oil & Gas Co. v. Universal Oil Prods.,* 1978 Tex. LEXIS 390; 24 UCC Rep. Serv. 555 (1978), Commented by K. Angelini, 'Product Liability—Implied Warranty—Recovery of Consequential Damages in Breach of Implied Warranty Action Disallowed to Extent Buyer's Negligence was Concurring Proximate Cause' (1979) 10 *St. Mary's L.J.* 675. This was also enacted in some State Statutes such as the case of New York and Texas. See also *Peterson v. Bendix Home Systems, Inc.,* 33 UCC Rep. Serv. 876 (1982); *5-Creek Ranch, Inc. v. Monier & Co.,* 12 UCC Rep. Serv. 820 (1973).

[22] G.H. Treitel, *Remedies for Breach of Contract: A Comparative Account,* Oxford, 1988, pp. 171, 190-1.

[23] Ibid at pp.190-1; see also at p.172, of the same book, for the intervention of an extraneous event for which neither party was responsible.

the loss of production was the seller's breach of warranty, the causation restriction would be satisfied and vice versa. However, under French law, the amount of recoverable damages may be reduced by the percentage of the buyer's contribution to the loss by misusing the machine. Under English law, the question is whether the seller's breach is sufficient enough to cause the loss. If the answer is in the affirmative, the buyer's contribution to the loss by misusing the goods will not be taken into account.

In view of the above discussion, where the CISG is the applicable law, parties to an international sale contract should not expect the causation restriction to be applied similarly among the various countries. Although the court may take into account the international character of the Convention, it is likely to be influenced by the domestic law of the country where it is based. In light of the above discussion, parties are advised to agree expressly on whether or not the contributory negligence can be taken into account for the purpose of quantifying damages.

7.2 Remoteness

Hadley v. Baxendale,[24] described by Gilmore as "a fixed star in the jurisprudential firmament",[25] has formulated the principle of remoteness in the common law.[26] The principle of remoteness was provided in *Hadley* as follows:

> "where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such a breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now if special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great

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[24] [1854] 9 Exch.341.

[25] Grant Gilmore, *The Death of Contract,* 1974, 83. For the significance of *Hadley v. Baxendale* and the reasons of formulation of its rule, see R. Danzig, '*Hadley v. Baxendale*: A Study in the Industrialization of the Law' (1975) 4 *J. Legal Stud.* 249.

[26] The rule of *Hadley* has roots in the Civil legal system; on this point see Franco Ferrari, 'Comparative Ruminations on the Foreseeability of Damages in Contract Law' (1993) 53 *La. L. Rev.* 1257.

> multitude of cases not affected by any special circumstances, from such a breach of contract."[27]

Although *Hadley* was a carriage of goods case where the breach was of a late delivery, its rule seems to be applicable to all kinds of contract. The principle of remoteness is intended to limit the seller's (the breaching party's) liability to those losses which were in the reasonable contemplation of the parties at the time of making the contract. To attain such a purpose, the rule of *Hadley* has been designed to prevent recovery for losses which flow from circumstances peculiar to the aggrieved party (the buyer) and not known to the party in breach at the time of making the contract.[28]

A significant advantage of the limitation stated in *Hadley* is the reduction of subsidization of loss. If the seller were liable for all the losses resulting from breach of warranty, his insurance premium would be higher. As a result, the price of the goods would increase due to the increase in the costs. Diamond and Foss argue that where sellers are unable to distinguish high risk buyers from others, as it is often the case, they may increase the price of their goods in order to compel the buying public to cross-subsidize the buyers' losses.[29] In other words, the sellers will force the buying public to pay higher prices in order to compensate the aggrieved buyers for their losses. However, since the remoteness principle limits the seller's liability to losses which result in the normal course of circumstances or in special circumstances known to the seller at the time of making the contract, it reduces the subsidization by the buying public. This is understandable from the fact that the sellers will not be liable for losses caused by their breach under special circumstances not known to them at the time of making the contract. Also, the original seller may not hesitate to issue a warranty to the ultimate buyers since he knows that he will not be liable for losses where the use of the goods could not reasonably have been contemplated at the time of making the contract.

Hadley, in applying the test of the reasonableness to the contemplation of the parties, distinguishes between contracts made under normal circumstances and those made under special circumstances. As for the former, the buyer does not need to prove that the seller was aware of such circumstances at the time of making the contract. The

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[27] *Hadley v. Baxendale,* (1854) 9 Exch. 341, 354-355.
[28] *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co. Ltd.,* [1978] 1 QB 791, 796.
[29] T.A. Diamond and H. Foss, 'Consequential Damages for Commercial Loss: An Alternative to *Hadley v. Baxendale'* (1994) 63 *Fordham L. Rev.* 665, 684.

remoteness principle would be satisfied if a reasonable man in the position of the seller would have contemplated the loss. However, in cases where the loss results under special circumstances, the buyer needs to prove that the seller was aware of such circumstances at the time of making the contract.

Legal writers disagree on the number of rules provided by *Hadley.* While the aforementioned statement of *Hadley* can be seen as one rule, some writers see it as two or three rules.[30] Those who favour the proposition of three rules, classify the losses into three categories, i.e., loss arising naturally, loss which can be contemplated by a reasonable man under normal circumstances and, finally, loss which arises in special circumstances.[31] In fact, the losses which arise naturally, must be contemplated at the time of making the contract.

As for the opinion favouring the proposition of two rules, legal writers may also disagree on the way of dividing the statement of *Hadley* into two rules. Some writers put the first rule to deal with those losses which can be in the reasonable contemplation of the parties and the second rule to deal with losses resulting under special circumstances peculiar to the aggrieved party. Some other writers put the first rule to deal with losses that can arise in the ordinary course of events and the second rule to deal with losses which are in the reasonable contemplation of the parties under normal or special circumstances.[32] Under the latter way of classification, the issue of remoteness cannot be discussed in cases where the loss arises in the ordinary course of events.

Unlike the UCC, the SGA adopts the first way of dividing the statement of *Hadley* into two rules. Section 53(2) of the SGA is a statutory formulation of the first rule which deals with the reasonable contemplation in cases of normal circumstances.[33] However, the Section is not intended to oust the second rule, which deals with cases of special circumstances.[34] The recovery in such cases can be held under Section 54 of the SGA. In fact, the UCC applies the second way of classification by denying the applicability of

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[30] P.S. James, 'Measure of Damages in Contract and Tort—Law and Fact' (1950) 13 *MLR* 36, 39.
[31] See J. Douglas Drushal, 'Uniform Commercial Code—§§ 2-714 & 2-715—Consequential Damages Award— *R.I. Lampus Co. v. Neville Cement Products Corp.*, 232 Pa. Super. 242, 336 A.2d 397 (1975)', [1976] 37 *Ohio St. L.J.* 153, 156. See also R.R. Anderson, supra n.3 at p.352.
[32] Michael Furmston (ed), *The Law of Contract,* London, 1999, p.1286; A.G. Murphey, 'Consequential Damages in Contracts for the International Sale of Goods and the Legacy of *Hadley'* (1989) 23 *Geo. Wash. J. Int'l L. & Econ.* 415, 431.
[33] See Section 53(2) of the SGA, supra p.50.

remoteness to the recoverability of damages for normal loss, which is the diminution in value of the goods in cases of breach of warranty, and restricting its application to the recoverability for consequential losses, e.g. loss of profit.[35]

In comparing the SGA with the UCC regarding this matter, one need not state which one deals better with the classification of the rule of *Hadley*. This is due to the fact that normal loss is naturally in the reasonable contemplation of the parties. Therefore, the recovery, in such cases, is unlikely to be denied by the application of the remoteness principle. In view of that, the classification of *Hadley* rule turns to be theoretical since it does not affect the recoverability of damages in practice. The UCC does not apply the remoteness principle to the recoverability of damages for normal loss.[36] This is not expressly stated in either the SGA or the CISG. Nevertheless, the remoteness principle seems to be unable to negate the recoverability for normal loss. Whereas consequential losses are likely to be remote in certain cases, normal loss cannot be remote since it should be, by its nature, in the reasonable contemplation of the parties at the time of making the contract. Therefore, it can be noted that normal loss is not subject, by its nature, to the restriction of remoteness.[37] A clear illustration of this can be obtained from a hypothetical example given by Prof. Treitel; "... a seller who has contracted to deliver an ounce of gold for its market price of (say) £230 instead delivers an ounce of some alloy of base metals resembling gold in appearance but worth only £5. Can there be any doubt that the buyer in such a case has suffered a loss of £225 simply because he has received an object worth that amount less than the object which the seller had contracted to supply? It is this rule which is contained in section 53(3)."[38] Personally, I cannot envisage a case in which the normal loss can be too remote. Clearly, the application of the remoteness principle to the recoverability of damages for normal loss may increase the buyer's burden of proof.

Provisions dealing with the remoteness principle, can also be found in the UCC and the CISG. Section 2-715(2) states that

> "Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at

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[34] *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co. Ltd.*, [1978] 1 QB 791, 807.
[35] See Sections 2-714, supra pp.51, 53.
[36] *R.E.B., Inc. v. Ralston Purina Co.*, 1975 U.S. App. LEXIS 12294; 525 F.2d 749 (10th Cir. 1975).
[37] G. H. Treitel, 'Damages for Breach of Warranty of Quality' (1997) 113 LQR 189, 190.
[38] Ibid, p.190.

the time of contracting **had reason to know** and which could not reasonably be prevented by cover or otherwise..." [Emphasis added].

Article 74 of the CISG provides that

"... damages may not exceed the loss which the party in breach **foresaw or ought to have foreseen** at the time of the conclusion of the contract, in the light of the facts and matters of which he then **knew or ought to have known**, as a possible consequence of the breach of contract." [Emphasis added].

The following will focus on the differences in the application of the remoteness principle under the SGA, the UCC and the CISG in order to find which one deals best with the principle of remoteness. It is intended to find out whether or not such differences make a difference in the recoverability of damages.

7.2.1 Subjective or Objective Test

Unlike the UCC and *Hadley*, Article 74 of the CISG adopts subjective and objective tests of foreseeability. Under the CISG, the buyer may be liable for losses which he foresaw or ought to have foreseen at the time of making the contract.[39] Although the language of the contemplation principle, under Section 2-715 of the UCC, is different from the language of *Hadley,* comment 2 to Section 2-715 of the UCC makes it clear that the Section follows the rule of contemplation stated in *Hadley*.[40] The rule of *Hadley*, indisputably, applies the objective test of contemplation. It makes the seller liable for losses which are reasonably in the party's contemplation at the time of making the contract. Even in cases of special circumstances, the seller will be liable for losses, which could reasonably be contemplated by the parties, resulting from the seller's breach under such special circumstances.

A comparison between the SGA and the UCC on the one hand and the CISG on the other hand may show that the application of the subjective test under the latter is inadequate. Under the subjective test, the buyer is required to prove the seller's actual contemplation. This seems to be quite difficult. The buyer may be able to prove that the

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[39] J.S. Sutton, 'Measuring Damages under the United Nations Convention on the International Sale of Goods' (1989) 50 *Ohio St. L.J.* 737, 743.

[40] Comment 2 to Section 2-715 of the UCC provides that "...the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance [*Hadley* rule] is followed..." See also *Linstrand v. Silvercrest Industries,* 31 UCC Rep. Serv. 978 (1981), where the Court made it clear that the principle of foreseeability under the UCC is concerned with the test whether the losses were reasonably foreseeable, not whether they were actually foreseen.

seller was aware of the special circumstances of the buyer at the time of making the contract and, thus, he should have contemplated the loss. If this becomes the case, the objective test will apply in order to hold that the loss should have been in the reasonable contemplation of the seller. In view of that, there seems to be no need for the application of the subjective test under the Convention.

7.2.2 Whose Contemplation?

The issue here is whether the remoteness principle requires the loss to be in the contemplation of the party in breach or both parties' contemplation. Plainly, the literal reading of the statement of *Hadley* indicates that the principle requires the loss to be in both parties' contemplation. This is absolutely not the case under both the CISG and the UCC where the remoteness principle requires the loss to be in the contemplation of the party in breach. In practice, such a difference is unlikely to lead to a difference in the recoverability of damages.[41] To my knowledge, there have been no cases where the recovery was denied on the ground that the loss was not in the contemplation of the aggrieved party. Furthermore, In *Cory v. Thames Iron Works Company,*[42] the Court rejected the argument that damages can only be for losses which *both* parties contemplated at the time of making the contract.[43]

On this point, Corbin says that the "question always turns on whether the *defendant* had reason to foresee the injury. No doubt the plaintiff nearly always knows his own business and circumstances better than the defendant.... Therefore, when courts say that both must have had reason to foresee the injury, the meaning is that the defendant must have had reason to foresee."[44] Thereupon, under the SGA, the UCC and the CISG, the application of the remoteness principle to cases of defective goods is mainly concerned with the reasonable contemplation of the seller.

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[41] A.G. Murphey, supra n.32 at p.435.
[42] [1868] 3 QB 181.
[43] Ibid at p.188.
[44] A.L. Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Working Rules of Contract Law,* West Publishing Co., Vol.5, 1964, p.83.

7.2.3 Contemplation of What?

It seems well settled under the SGA and the UCC that the contemplation is of the kind of loss and not of the extent.[45] Under Article 74 of the CISG, the recoverable damages must not exceed "the loss which the party in breach foresaw or ought to have foreseen". The words of Article 74 make it hard to tell whether the required foreseeability is of the kind of loss or of the amount of loss. This may cause a variation in the application of the Article among the different countries. For example, if the Convention is applied in England or America, the foreseeability requirement may be applied to the kind of loss and not to its amount. However, this may not be the case, for example, in France. The French view, which requires the foreseeability of the amount of loss, might influence the French court in applying Article 74 of the Convention.[46]

As for the degree of contemplation or foreseeability, the point was discussed by distinguished members of the House of Lords in the *Heron II*.[47] Their Lordships provided many expressions describing the degree of contemplation. Damages can be recovered for loss which is in the reasonable contemplation of the parties as not unlikely to result,[48] as liable to result or at least it was not unlikely to result[49] or there is real danger[50] that the loss will result from the breach of contract. In fact it is hard to state an interpretation for each expression. A great deal remains for the court to apply these brilliant expressions.

In comparison, one may note that the SGA and the UCC are similar in applying the principle of remoteness. However, the application of the remoteness principle under the Convention may be influenced by domestic laws. If the Convention is applied in France, for example, the remoteness principle may be applied to the amount as well as the kind

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[45] As regards the SGA, see *Parson Ltd.v. Uttley Ingham & Co.* [1978] 1 QB 791, 813; see also *Christopher Hill Ltd. v. Ashington Piggeries Ltd.,* [1969] 3 All ER 1496. As for the UCC, see *Barnard v. Compugraphic Corp.,* 37 UCC Rep. Serv. 141 (1983).

[46] G.H. Treitel, supra n.22 at p.154.

[47] *Koufos v. C. Czarnikow Ltd. (Heron II)* [1969] 1 AC 350.

[48] Ibid at p.383. Lord Reid used "the words 'not unlikely' as denoting a degree of probability considerably less than an even chance but nevertheless not very unusual and easily foreseeable." Lord Reid, in this case, cited the case of *R. & H. Hall Ltd. v. W. H. Pim (Junior) & Co. Ltd.,* [1928] 33 Com. Cas. 324, decided by the House of Lords. In this case, Lord Shaw, at p.333, stated that "[t]he main business fact is that [the parties] are thinking of the contract being performed and not of its being not performed. But with regard to the latter if their contract shows that there were instances or stages which made ensuing losses or damage a not unlikely result of the breach of the contract, then all such results must be reckoned to be within not only the scope of the contract, but the contemplation of the parties as to its breach."

[49] *Koufos v. C. Czarnikow Ltd. (Heron II)*, ibid at p.406.

[50] Ibid at pp.414-415.

of loss. The application of the principle of remoteness to the amount of loss may not be easy in most cases. Here, one may question whether it is possible for the parties to foresee the amount of the loss at the time of making the contract. This may be possible in cases of expenses incurred in hiring a substitute while the goods are being repaired. However, it seems too difficult to prove the seller's contemplation as to the amount of loss of profit or the severity of physical damage resulting from the defective quality of goods. The purpose of the principle of remoteness is to protect the seller against the buyer's claims for unusual losses which cannot be in his reasonable contemplation at the time of making the contract as not unlikely to result from the breach. Therefore, there seems to be no point to apply such a principle to the extent of the loss where the kind of loss is not too remote.

7.2.4 Contemplation or Foreseeability? Probability or Possibility?

The terms "contemplation" and "foreseeability" were first used in the Louisiana Civil Code. An interesting analysis by Professor Murphey makes it clear that the terms were, most likely, used interchangeably.[51] In the case of *Hadley*, the Court used only the term "contemplation". It is unclear whether the Court in *Hadley* used the term contemplation to mean foreseeability or it intended to impose a stricter limitation on the recovery of damages in contract. The term foreseeability was used in *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.*,[52] to deny the recovery for loss of profit under special contracts which were not made known to the seller at the time of making the contract. The use of foreseeability in this case was criticized in *Heron II*[53] by the majority of the House of Lords. In this case, Lord Reid pointed out that while the term "foreseeability" can be used in tort, the term "contemplation" can be used only in contract to impose a stricter limitation on the recovery of damages.[54] This attitude was criticized by Lord Denning, M.R. in *Parson Ltd. v. Uttley Ingham & Co.*[55] Referring to Lord Denning, the distinction between what was foreseeable by the parties and what was in the contemplation of the parties seems to be a semantic exercise. In his opinion, in cases of physical losses, the principle of remoteness should apply in tort and contract similarly. It

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[51] A.G. Murphey, supra n.32 at p.436.
[52] [1949] 2 KB 528, 539.
[53] *Koufos v. C. Czarnikow Ltd. (Heron II)* [1969] 1 AC 350.
[54] Ibid at p.385.
[55] [1978] 1 QB 791. Supra p.165.

has been submitted[56] that the difference in actions should by no means lead to a difference in the outcomes.

Although the UCC applies the standard of "*had reason to know*" and does not adopt any of the terms "contemplation or foreseeability", comment 2 to Section 2-715 of the UCC makes it clear that the Section follows the rule of *Hadley.* However, the American courts, which seem to agree on the distinction drawn between foreseeability and contemplation, apply the term "foreseeable" to the cases of contract. By doing so, the American courts relaxes the rigour of the remoteness principle in order to increase the possibility of recovery for consequential losses.[57]

Clearly, Article 74 of the CISG adopts the term "foreseeability" which might make the chance of recovery under the Convention more than under the SGA. Article 74 allows damages for "the loss which the party in breach foresaw or ought to have foreseen at the time of making the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach." In fact, the use of the word possible in the wording of Article 74 may also liberalize the application of the remoteness principle. Some legal writers, such as Ziegel,[58] consider the mere word "*possible*" a very broad word. Ziegel suggests here that the words of Article 74 should be interpreted narrowly in order to prevent the injured party being saddled with extravagant damage claims. However, the use of the clause "in the light of the facts", as Farnsworth suggests,[59] might be seen as a limitation to the broad meaning of the word "possible".

Hadley used the word "probable" which has a narrower meaning than the meaning of the word possible.[60] The expression "serious possibility", which was used in *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.*,[61] to describe the degree of

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[56] Supra p.165.
[57] A.G. Murphey, supra n.32 at p.439.
[58] J S Ziegel, *International Sales (Conference at Pankers School), Some Common Law Perspective*, New York, 1984, Ch. 9, p.39.
[59] Farnsworth, 'Damages and Specific Relief' (1979) 27 *Am. J. Comp. L.* 247, 253.
[60] In *R. & H. Hall Ltd. v. W. H. Pim (Junior) & Co. Ltd.*, [1928] 33 Com. Cas. 324, Lord Viscount Dunedin pointed out, at p.329, that "I do not think that 'probability'... means that the chances are all in favour of the event happening. To make a thing probable, it is enough, in my view, that there is an even chance of its happening."
[61] [1949] 2 KB 528, 540.

contemplation, was rejected by the House of Lords in *Heron II.*[62] Section 2-715 of the UCC has different words, i.e. "had reason to know", which do not include either "possible" or "probable". The terms "foreseeability" and "probable" can be found in Section 351 of the American Restatement (Second) of Contracts 1979 which states that "Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made." While the word "foresee" provides a flexible application of the remoteness principle, the word "probable" limits such a flexibility. Farnsworth, in comparing the test of remoteness under the CISG, the UCC and the Restatement, stated that although "the use [in Article 74 of the CISG] of "*possible* consequence" may seem at first to cast a wider net than the Restatement's "*probable* result," the preceding clause ("in the light of the facts...") cuts this back at least to the scope of the [UCC] language".[63]

In comparing *Hadley* with the UCC and the CISG regarding the terminology used in stating the remoteness principle, one should look first at the purpose of the remoteness principle. As mentioned above, the purpose of such a principle is to protect the seller. Therefore, the principle provides an exception to the general rule that the party should be liable for all losses caused by his breach. The scope of such an exception, as reducing or disallowing the recoverable damages under the principle of *Robinson v. Harman*,[64] should not be wider than the scope provided by *Hadley*. As the remoteness principle was formulated under the common law by *Hadley,* the scope of such a principle should not be widened by using broad terminology such as foreseeability and possibility. Thereupon, it can be noted that English should be the leading law in applying the principle of remoteness. However, the use of such terminology under the CISG may be justified by the fact that the convention is a compromise between the several legal systems.

7.2.5 Communication of Special Circumstances

Logically, the seller needs to be aware, at the time of making the contract, of the special circumstances under which the loss is caused in order to be held liable.[65] Special

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[62] [1969] 1 AC 350, 390.
[63] Farnsworth, supra n.59 at p.253.
[64] (1848) 1 Exch 850, 855. Supra, p.1.
[65] See *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.*, [1949] 2 K.B. 528 where the buyer was not allowed damages for his loss of profits which the seller was not aware of at the time of making the

circumstances vary from case to another depending on many factors, such as the kind of the relationship between the parties, the nature of the buyer and the nature of goods.

Where the parties have been in a long business relation and, thus, aware of the business position of each other, the seller should be aware of the abnormal purpose of purchasing the goods. Therefore, where the seller is aware that the goods have been purchased in order to be manufactured, he should know that his breach will cause loss of profit to the buyer.[66] However, it may be a kind of special circumstance if the buyer loses profit under special contracts. If this becomes the case, the seller should be informed of such special contracts, at the time of making the original contract, in order to be held liable.[67] Likewise, where the nature of the goods indicate their use, e.g. profit making goods,[68] the seller cannot deny his liability on the ground that he was not aware of the future use of the goods.[69] Nevertheless, the buyer is advised to notify the seller of the intended use of the purchased goods, especially in cases where such goods can be put to several uses or are intended to be put to an uncommon use.[70]

7.2.5.1 The Time of Communication

Under the rule of *Hadley,* the UCC and the CISG, the buyer needs to communicate his special circumstances to the seller at or before the time of making the contract. In this sense, if the buyer notifies the seller of the special circumstances after the time of

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contract. See also the UCC case of *City of New York v. Pullman, Inc.*, 31 UCC Rep. Serv. 1375 (2n Cir. 1981).

[66] For example, in the UCC case of *Lewis v. Mobile Oil Corp.*, 8 UCC Rep. Serv. 625 (8th Cir. 1971), where the seller was aware, at the time of making the contract, that goods were purchased in order to be used in manufacturing process, the court found it reasonable to assume that the seller knew or should have known that the defective goods will cause disruption of production and, as a natural consequence, the buyer will suffer loss of profit.

[67] *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.*, [1949] 2 KB 528.

[68] For the quantification of damages for breach of warranty of quality of profit-making goods, see chapter four, supra p.129.

[69] M.A. Eisenberg, 'the Principle of *Hadley v. Baxendale'* (1992) 80 *Cal. L. Rev.* 563, 589. However, one can find some UCC cases where the court has misdirected itself when it held that the circumstances of the buyer were special. For example, in *Keystone Diesel Engine Co. v. Irwin,* 1 UCC Rep. Serv. 184 (1963), the Court considered the commercial use of a tractor is a kind of special circumstances which had not been communicated to the seller at the time of making the contract. As a result, the Court refused to allow damages for the loss of use of the tractor which resulted from the purchased defective engine. In fact, it would have been more reasonable for the court to assume that a seller who is aware that the diesel ingine is purchased in order be be used in a tactor, should know that the seller will suffer loss of profit if the engine delivered appeared defective. See also *R.I. Lampus Co. v. Neville Cement Products Corp.*, 22 UCC Rep. Serv. 1172 (1977). Discussed in R.R. Anderson, supra n.3 at pp.356-357.

[70] In case of warranty of fitness for specific purpose, the buyer might find it difficult to prove the existence of such a warranty if he did not inform the seller of the specific purpose of the goods at the time of making the contract.

making the contract, the seller will be liable only for losses which result in the normal course of circumstances. In other words, the seller's awareness of such special circumstances after the time of making the contract will not be taken into account for measuring his liability.

The time of communicating special circumstances is intended to protect the party in breach. The seller who becomes aware of the buyer's special circumstances at the time of making the contract, may refuse to enter into such a transaction. Alternatively, the seller may take some protective measures by raising the price of the goods or contractually limiting his liability for specific losses or by taking special precautions to assure the conformity of the goods with the contract.[71] It is clear that if the seller becomes aware of special circumstances after the time of making the contract, he may lose the chance of taking protective measures and this will unfairly increase his liability. Here, it should be clear that this does not apply to information which are available to both parties, such as information concerning market condition. Such information may not be considered as special circumstances since they do not concern the buyer only.[72]

7.2.5.2 The Source of Knowledge of Special Circumstances

Unlike *Hadley*, neither the CISG nor the UCC provides a special source of the seller's knowledge of special circumstances. Under the UCC, the buyer's special circumstances will not prevent or reduce his recovery if the seller "had reason to know" such special circumstances at the time of making the contract.[73] Likewise, under the CISG, such circumstances will not be an obstacle to the recovery if the seller "knew or ought to have known" them at the time of making the contract.[74] The CISG does not provide a definition for the expression of "ought to have known". Here, it is worth mentioning that Article 13 of the Uniform Law on the International Sale of Goods 1964 (henceforth ULIS) defines such an expression as that which "should have been known to a reasonable person in the situation". Clearly, under such a standard, the seller may not be

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[71] H.L. MacQueen, 'Remoteness and Breach of Contract' [1996] *Jur. Rev.* 295, 298. However, see T.A. Diamond and H. Foss, supra n.29 at p.694, where the authors argue that although the principle of *Hadley v. Baxendale* is efficiency enhancing on the basis of the stratification of pricing and precaution, such efficiency is likely to be reduced by costs of communicating and utilizing the relevant information.

[72] T.A. Diamond and H. Foss, supra n.29 at p.695.

[73] This was held in many UCC cases such as *Kunststoffwerk Alfred Huber v. R. J. Dick, Inc.*, 28 UCC Rep. Serv. 1371 (3rd Cir. 1980); *United California Bank v. Eastern Mountain Sports, Inc.*,34 UCC Rep. Serv. 806 (1982).

[74] Article 74 of the CISG.

required to search for information concerning the circumstances of the buyer. However, Honnold seems to have a strict interpretation of the expression. He has made an interesting comparison between two expressions used in the Convention, i.e., "ought to have known" and "could not have been unaware". In his opinion, "the facts one 'ought to have known' include those facts that would be disclosed by an investigation or inquiry that the party should make. But an obligation based on facts of which one 'could not have been unaware' does not impose a duty to investigate -- these are the facts that are before the eyes of one who can see."[75] Anyhow, one finds it hard to accept that the seller is obligated to investigate under the standard of "ought to have known" since this will put the seller in an insecure and burdensome situation. This is why the buyer is advised to communicate to the seller his circumstances which might be special.

The literal reading of the aforementioned statement of *Hadley* indicates that the buyer needs to communicate his special circumstances to the seller at the time of making the contract. However, it is unlikely that the court will deny the liability of the seller, who was aware of such special circumstances at the time of making the contract, on the ground that the special circumstances were not communicated to him by the buyer. In fact, the full reading of the aforementioned statement of *Hadley* may support this conclusion. The last sentence of the statement limits the seller's liability to those losses, which can arise in normal circumstances, if special circumstances were wholly unknown to the seller at the time of making the contract. The statement was plainly concerned with the breaching party's lack of knowledge of such special circumstances and not with the failure of the aggrieved party to communicate such special circumstances. This indicates that the source of the seller's knowledge of the special circumstances is of no significance in cases where such a knowledge is proved or not denied. Furthermore, in *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.,*[76] the Court made it clear that what is reasonable and so "foreseeable depends on the knowledge then possessed by the parties or, at all events, by the party who later commits the breach."[77] Furthermore, in *Heron II*[78] the House of Lords was concerned with the contemplation of the breaching party in light of "the information available to [him] when the contract was made".[79]

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[75] J. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, Boston, 2nd ed., 1991, p.308.
[76] [1949] 2 KB 528.
[77] Ibid at p.539.
[78] *Koufos v. C. Czarnikow Ltd. (Heron II)* [1969] 1 AC 350.
[79] Ibid at p.385

7.2.5.3 The "Tacit Agreement" Rule

The issue here is whether the seller is required to agree on his liability for losses resulting under special circumstances. Although *Hadley* makes it clear that the remoteness principle requires the loss to be in the reasonable contemplation of the parties, one can find cases where the court required the breaching party to agree, expressly or impliedly, on his liability for losses resulting under special circumstances.[80] The mere reading of the rule of *Hadley* regarding cases of special circumstances can show two points: first, the rule requires the reasonable contemplation, and not the assent, of the party in breach; second, the rule applies an objective test by requiring the loss to be in the *reasonable* contemplation of the parties in light of the special circumstances they are aware of.[81] In view of that, if it was reasonable for the party in breach to contemplate the loss at the time of making the contract in light of the special circumstances he was aware of, he might be held liable regardless of whether he contemplated the loss in fact or not.[82] Consequently, it can be noted that the requirement of the assent of the breaching party to his liability for losses under special circumstances is based on a misinterpretation of the rule of *Hadley*.

Under American law, the requirement of the seller's assent has been abandoned. Such a requirement is called the "tacit agreement" rule. The rule applies to the liability for all kinds of consequential loss regardless of whether they result under normal or special circumstances. Under such a test, the buyer should believe that the seller has accepted the liability for consequential loss. However, the seller's acceptance or rejection of such a liability is tacit. That is to say that the circumstances of the contract formation had to show that the seller agreed, expressly or impliedly (tacitly), to be liable for consequential losses resulting from his breach.[83] In this sense, the buyer should have a reason to believe that the seller accepts the liability for consequential loss. The "tacit agreement" rule was rejected expressly by the UCC by adopting the standard of "had

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[80] In the case of *British Columbia Saw-Mill C. Ltd. v. Nettleship,* (1868) 3 C.P. 499, which was decided fourteen years after the case of *Hadley,* the Court stated, at p.506, that the party in breach is liable for the loss which he "could have foreseen and reasonably expected and to which he has assented expressly or impliedly by entering into the contract."

[81] J.J. Gow, 'A Comment in the Rule in Hadley v. Baxendale' (1954) 27 *Austl. L. J.*, 666, 667.

[82] However, see J.F. Wilson and C.J. Slade, 'A Re-examination of Remoteness' (1952) 15 *MLR* 459, 460.

[83] J. D. Drushal, 'Uniform Commercial Code- Sections 2-714 & 2-715- Consequential Damages Award- *R.I. Lampus Co. v. Neville Cement Products Corp.*, 232 Pa. Super. 242, 336 A.2d 397 (1975), [1976] 37 *Ohio St. L.J.* 153, 157.

reason to know". Comment 2 to Section 2-715 of the UCC states expressly that the "tacit agreement" test for the recovery of damages is rejected. Similarly, under the CISG, Article 74 speaks about the foreseeability of the loss. In other words, the acceptance of the party in breach of his liability for losses is clearly not required under the standard of remoteness adopted in Article 74 of the Convention.

The "tacit agreement" test seems to be in contradiction with the rule of *Hadley*. The buyer should not be required to prove that the seller agreed expressly or impliedly that he will bear the loss resulting under special circumstances. Although such an agreement may be understood from the decision of the seller to contract with the buyer, one may note that the rule of *Hadley* cannot be interpreted to require the buyer's express or implied agreement.

7.3 Mitigation

Under the mitigation principle, the buyer is not entitled to recover for losses he has avoided or ought to have avoided.[84] The principle also goes further to reduce the buyer's damages by an amount equivalent to what he has gained or ought to have gained[85] as a result of the breach.[86] In certain cases of breach of warranty of quality, the buyer may save expenses he would have incurred had the goods been in conformity with the contract. Here, damages may be reduced by the amount of the saved expenses and the profit that could reasonably be obtained by investing such expenses.[87] On the other hand, the principle of mitigation may increase the buyer's damages by allowing him the expenses he has incurred in his reasonable attempts to mitigate the loss regardless of whether such attempts were successful or not.[88]

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[84] See the UCC case of *Carnation Co. v. Olivet Egg Ranch,* 1 UCC Rep. Serv. 2d. 1531 (1986), where the buyer could not recover for his loss of goodwill which he could reasonably have avoided. See also *International Petroleum Services, Inc. v. S & N Well Service, Inc.*, 1982 Kan. LEXIS 200; 33 UCC Rep. Serv. 217 (1982); *Ford Motor Co. v. Fairley,* 1981 Miss. LEXIS 2000; 32 UCC Rep. Serv. 440 (1981); *Melotz v. Scheckla* Mont. 1990 LEXIS 370; 13 UCC Rep. Serv. 2d 9 (1990).

[85] This does not include what the buyer receives under financial precautions taken before injury against the eventuality of injury, such as insurance, pension, or the like. See Harvey McGregor, *McGregor on Damages,* London, 16th ed., 1997, 220. However, in the UCC case of *Jackson v. Glasgaw* 1980 Okla. Civ. App. LEXIS 133; 30 UCC Rep. Serv. 482 (1980), the Court took into account the money received under an insurance policy to reduce the amount of recoverable damages. It is submitted that the Court misdirected itself in this case.

[86] See *British Westinghouse Electric Co. Ltd. v. Underground Electric Rys.* [1912] AC 673.

[87] See chapter four at p.137. See also G.H. Treitel, supra n.22 at p.185.

[88] See the CISG case of *Delchi Carrier , SpA v. Rotorex Corp.*, <http://cisgw3.law.pace.edu/cases/940909u1.html> discussed in E.C. Schneider, 'Consequential Damages in the International Sale of Goods:

The principle applies under the SGA, the UCC and the CISG. In *British Westinghouse Co. v. Underground Ry.*,[89] it was made clear that the buyer cannot recover for losses which could have been avoided by taking reasonable steps.[90] Section 2-715(2) of the UCC makes it clear that the buyer can recover only for consequential losses "which could not reasonably be prevented by cover or otherwise...". Likewise, Article 77 of the CISG states

> "A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated."

Here, it should be noted that the principle has similar application under the SGA, the UCC and the CISG. Therefore, unless otherwise is stated, the methods of mitigation discussed below apply similarly under the SGA, the UCC and the CISG. However, there are still some differences between English law and the UCC regarding the application of the remoteness principle. For example, unlike English law and the CISG, the UCC applies the principle of mitigation to the recoverability for consequential losses only. In other words, where the buyer's claim is for damages for the diminution in value, the seller cannot raise the defence of mitigation. However, damages should be awarded for the *actual* loss suffered by the buyer. By allowing the buyer damages for more than his actual loss, the buyer will be put in a better position than he would have been in if the goods had been delivered as warranted. Section 2-714 of the UCC allows damages for the losses suffered by the buyer. Therefore, it is submitted that the mitigation principle should apply to all cases regardless of the type of loss caused by the seller's breach. In fact, although the UCC seems to apply the mitigation principle to cases of consequential loss only, American courts may go beyond the UCC to apply the principle to all cases, such as the case of *Robertson Mfg. Co. v. Jefferson Tile Co.*,[91] discussed Below.

Analysis of Two decisions' (1995) 16 *U. Pa. J. Int'l Bus. L.* 615. See also J.E. Murray, *Murray on Contracts*, 3rd ed., p.702.

[89] [1912] AC 673, 689.

[90] It should be clear that the mitigation is not a duty owed to the party in breach. However, the buyer will not be entitled to recover for losses which could reasonably be avoided. See here *Sotiros Shipping Inc. v. Sameiet Solholt (The Solholt)* [1983] 1 Lloyd's Rep. 603, 608.

[91] 5 UCC Rep. Serv. 119.

7.3.1 Reasonable Steps of Mitigation

Under the mitigation principle, the buyer is required to take reasonable steps to mitigate his loss. Deciding whether certain steps are reasonable or not, is a matter of fact which depends on the circumstances of each case. In general, the standard of conduct of mitigation is not too high since the seller is a wrongdoer.[92] The buyer is not "under any obligation to do anything other than in the ordinary course of business".[93] Furthermore, where the buyer has acted reasonably to mitigate his loss, damages would unlikely be reduced on the ground that the buyer could have taken better steps to mitigate his loss.[94]

Under the SGA, the UCC and the CISG, the buyer is not required to undertake undue risk or burden in its effort to mitigate.[95] In this sense, the buyer is not required to take impractical steps which are beyond his financial means[96] or which requires expenditure disproportionate to the loss sought to be avoided.[97] Also the buyer does not need, for the purpose of mitigation, to perform sub-sale contracts by delivering non-conforming goods if that would involve damaging his own commercial reputation.[98]

7.3.2 Methods of Mitigation

Where the buyer has mitigated his loss, damages should be awarded under the principle of *Robinson v. Harman*[99] since by allowing the buyer damages for the avoided loss, he will be placed in a better position than he would have been in if the goods had been free from defects. However, where the buyer has failed to mitigate his loss, which could

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[92] A.G. Guest, supra n.11 at para.27-088.

[93] In *Dunkirk Colliery Co. v. Lever,* (1878) 9 Ch.D. 20, James LJ, at p.25, pointed out that "[t]he person who has broken the contract is not to be exposed to additional cost by reason of the plaintiffs not doing what they ought to have done as reasonable men, and the plaintiff not being under any obligation to do anything otherwise than in the ordinary course of business."

[94] In *Banco de Portugal v. Waterlow* [1932] AC 452, Lord Macmillan pointed out, at p.506, that "[t]he law is satisfied if the party placed in a difficult situation by reason of the breach of a duty owed to him has acted reasonably in the adoption of remedial measures and he will not be held disentitled to recover the cost of such measures merely because the party in breach can suggest that other measures less burdensome to him might have been taken."

[95] J.J. White and R.S. Summers, *Uniform Commercial Code,* 4th ed., 1995, p.382.

[96] See the UCC case of *Nyquist v. Randall* 1987 U.S. App. LEXIS 7774; 3 UCC Rep. Serv. 2d 1823 (11th Cir. 1987).

[97] See *Kirby v. Chrysler Corp.* 1982 U.S. Dist. LEXIS 16377; 35 UCC Rep. Serv. 497 (1982), where the Court made it clear that the concept of mitigation does not require a buyer to purchase additional equipment from the seller to correct the defects of the original goods nor to solicit dissatisfied customers of the buyer where there was no reason to believe that either course of action would have been successful to reduce the buyer's loss. See also *Barnard v. Compugraphic Corp.* 1983 Wash. App. LEXIS 2655; 37 UCC Rep. Serv. 141 (1983); *Gerwin v. Southeastern California Association of Seventh Day Adventist,* 1971 Cal. App. LEXIS 988; 8 UCC Rep. Serv. 643 (1971).

[98] *James Finlay & Co. Ltd. v. N. V. Kwik Hoo Tong Handel Maatschappij* [1928] 2 KB 604.

have been avoided by taking reasonable steps, damages recovered under the principle of *Robinson* should be reduced by an amount equivalent to the avoidable loss.

Methods of mitigation widely vary depending on the nature of goods and buyers. For example, an experienced buyer is expected to take better steps to mitigate his loss than a normal consumer. Here, two main ways of mitigation of loss, resulting from breach of warranty of quality, need to be examined. The buyer may mitigate his loss by stopping using the defective goods; the buyer may also mitigate his loss by accepting the seller's offer to repair or restore the contract price and take the goods back.

7.3.2.1 Mitigation by Stopping using Defective Goods

The buyer may not be entitled to damages for losses he has suffered by continuing to use defective goods after he knew or ought to have known of the defect.[100] Likewise, the buyer should not resell the goods, as free of defects, after he knew or ought to have known that they were defective.[101] However, he may resell the defective goods at a cheaper price[102] if by doing so, he can mitigate his loss.[103] Where the buyer knew of the defect after he had resold the goods, he should pass his knowledge of the defect to the subpurchasers. The failure of the buyer to pass such a knowledge may affect the recoverability of damages for his liability to the subpurchasers. In this case, indemnity paid to subpurchasers for losses resulting from the use of defective goods after the buyer became aware of the defect, is likely to be excluded from the original seller's liability.[104]

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[99] (1848) 1 Exch 850, 855. Supra, p.1.

[100] See *Lambert v. Lewis* [1982] AC 225. See also the UCC cases of *KLPR TV, Inc. v. Visual Electronics Corp.* 11 UCC Rep. Serv. 50, in which the Court did not allow the buyer damages for losses resulting from the use of defective television which was patently defective; *Barry & Sewall Industrial Supply Co. v. Metal-Prep of Houston, Inc.* 12 UCC Rep. Serv. 2d 708 (8th Cir. 1990) in which the buyer was not allowed damages for his financial loss resulting from the use of patently defective infrared oven; *R.I. Lampus Co. v. Neville Cement Products Corp.,* 16 UCC Rep. Serv. 996; *Fla-Hapag-Lloyd, A..G. v. Marine Indem. Ins. Co.* 14 UCC Rep. Serv. 2d 462 (1991).

[101] *Biggin v. Permanite* [1951] 1 KB 422; the case was reversed on different point [1951] 2 KB 314.

[102] See the UCC case of *Larry Goad & Co. v. Lordstown Rubber Co.,* 1983 U.S. Dist. LEXIS 18217; 36 UCC Rep. Serv. 167 (1983).

[103] In cases of perishable goods or goods which decline speedily in value, the buyer should make reasonable efforts to resell the goods or try to stop the diminution in value as the case may be. See the CISG case of *ICC Arbitration Case No. 7331 of 1994,* <http://cisgw3.law.pace.edu/cases/947331i1.html>. In case of productive goods, the buyer might mitigate his loss by leasing substitute goods while the defective goods are in the process of repair. See the UCC case of *Cancun Adventure Tours, Inc. v. Underwater Designer Co.,* 1988 U.S. App. LEXIS 16367; 8 UCC Rep. Serv. 2d 1035 (4th Cir. 1988).

[104] A.G. Guest, supra n.3 at p.592.

Here, one may consider the decision in *Parson Ltd. v. Uttley Ingham & Co.*[105] In this case, the buyers should have mitigated their loss by stopping using the mouldy nuts. The Court of Appeal did not discuss this point. In fact, the act of feeding the pigs the mouldy nuts should have been considered as an intervening act which could have broken the chain of causation. Nevertheless, the Court of Appeal did not discuss the restrictions of causation and mitigation in this case.[106]

However, the mitigation principle does not always require the buyer to stop using the defective goods. One can envisage some cases where the buyer may be justified in continuing to use the defective goods. Where the seller expressly assures the buyer that the goods are not defective, the seller's defence that the buyer failed to mitigate by continuing to use the allegedly defective goods may not be successful.[107] The buyer under the mitigation principle is required to cooperate with the seller in order to minimize his loss. So, if the seller induced the buyer to use the goods by assuring him that the goods are not defective, the seller should be responsible for all the losses caused by the proper use of the defective goods.

In certain cases, the mitigation principle goes further to require the buyer to mitigate his loss by continuing to use the defective goods.[108] For example, in the UCC case of *Prutch v. Ford Motor Co.*[109] the Court made it clear that the purchaser's decision to use defective equipment in their attempt to produce at least part of normal crop at all was required by their duty to lessen, rather than increase, their losses. Thus, the seller could

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[105] [1978] 1 QB 791. The facts of this case are mentioned in chapter five, supra p.165.

[106] Sir Robin Cooke has observed that Lord Denning did discuss causation in one version of the reports of his judgment. Sir Robin Cooke says: "In the fuller version of [Lord Denning's] judgment in *Lloyd's Reports* [1977 Lloyd's Rep. 522, 525] there is a passage in which his Lordship discusses causation and mentions that when the act of third parties intervene the likelihood of the consequences is very relevant. In editing his judgment for the *Weekly Law Reports* and the *All England Reports,* he has evidently condensed this passage. Perhaps we may infer that Lord Denning decided that it was better not to embark on such a vexed topic. Yet there can be no doubt that there was intervening human action in the *Parsons* case, in the deliberate feeding of the mouldy nuts to the pigs, albeit by the plaintiffs themselves." Sir Robin Cooke, 'Remoteness of Damages and Judicial Discretion' [1978] *CLJ* 288, 296.

[107] See the UCC cases of *Edwards-Warren Tire Co. v. J.J. Blazer Constr. Co.,* 22 UCC Rep. Serv. 906 (1977) where the buyer insisted that there is no breach of warranty, the court held that the buyer was justified to continue to use the goods in question. See also *Delta Motors, Inc. v. Childs (Miss)* 101 So 2d 527 (Miss 1958).

[108] This might be the case where the defective goods are less productive than they were warranted under the contract. In such a case, where the substitute is not available or the cost of obtaining the substitute would increase the seller's liability to be more than if the buyer continued to use the goods, the buyer may be required, under the mitigation principle, to continue to use the goods unless special circumstances indicate otherwise. The quantification of the buyer's loss of profit in cases of deficient production is dealt with in chapter four, supra p.130.

[109] 29 UCC Rep. Serv. 1507.

not avoid his liability by claiming that the purchasers failed to mitigate by continuing to use the defective equipment. Similarly, in the UCC case of *Burrus v. Itek Corp.*,[110] the Court held that the buyer was justified in continuing to use a defective press in an effort to maintain his business since the seller refused to provide a replacement and, thus, the buyer had no choice in the matter.

7.3.2.2 Mitigation by Accepting the Seller's Offer to remedy his Breach

Where the opportunity of mitigation of loss comes through the seller's offer to repair or otherwise, the buyer's refusal of the offer may result in a reduction of his damages. In other words, the buyer's damages may be reduced by the amount of the loss which could have been mitigated had the buyer accepted the offer.

A) Offer to Repair or Replace

The buyer may be required to accept the seller's offer to cure the breach in order to mitigate his loss. This can be understood from the decision in *Payzu Ltd. v. Saunders.*[111] In this case, the seller agreed to sell a quantity of silk to the plaintiffs. After some delays in payment, the seller refused to make further deliveries except for cash. The plaintiffs accepted this repudiation of the contract. The market price had risen considerably. The plaintiffs sought to recover the difference between the contract price and the market price. The Court of Appeal made it clear that the plaintiffs should have mitigated their loss by accepting the seller's offer, i.e. delivery of goods for cash.

Here, the application of the reasonableness test is of a vital significance. Where it is unreasonable for the buyer to accept the seller's offer to cure, the mitigation principle may not be a successful defence against the buyer's claim for breach of warranty of quality.[112] For example, in the UCC case of *Stair v. Gaylord,*[113] where the buyer refused

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[110] 21 UCC Rep. Serv. 1009.

[111] [1919] 2 KB 581. The case involves the buyers' claim for non-delivery. However, it is submitted that the same conclusion can be reached in cases of breach of warranty of quality. See also *Sotiros Shipping Inc. v. Sameiet Solholt (The Solholt),* [1983] 1 Lloyd's Rep. 603 where the seller failed to deliver the purchased ship on the contractual date of delivery, the Court found that it was reasonable for the buyer to mitigate his loss by accepting her late delivery.

[112] The mitigation principle does not require the buyer to accept defective goods. For example, in *Rogers and another v. Parish (Scarborough) Ltd. and Others*, [1987] QB 933 the buyer purchased a Range Rover car from a dealer. The car appeared defective and the dealer replaced it. The new car appeared defective. The buyer had the benefit of a manufacturers' guarantee which provided, that for 12 months after delivery, parts requiring replacement or repair because of a manufacturing or material defect would be replaced or

replacement for a defective hose in an irrigation system because of delay in delivery of the replacement, it was held that the buyer was entitled to damages with regard to the defective goods accepted. Similarly, in *Travelers Indemnity Co. v. MAHO Machine Tool Corp.,*[114] the seller offered to replace the defective goods. The offer was subject to the transportation of the defective goods from Singapore to Germany[115] at the buyer's expense. The buyer did not have enough money to pay for the carriage. The Court held that, in light of the facts of the case, the buyer was not required to accept the seller's offer in order to mitigate his loss.

As regards the CISG, the words of Article 77 are broad enough to cover all the reasonable methods of mitigation. Where offers to repair are normally reasonable in domestic sales, the case might be different in the international sales. A seller to an international sale of goods contract may require a long time to repair the defect. The process of repair may involve the transportation of the defective goods to the manufacturer. If this appears to be unreasonable in the circumstances, the buyer may not be required to accept such an offer in order to comply with the mitigation principle.

B) Offer to restore the contract price and take the goods back

Where it is reasonable for the buyer to accept the seller's offer to restore the contract price and take the goods back, he may be required to accept such an offer in order to comply with the mitigation principle. This was the case in *Houndsditch Warehouse Co. v. Waltex,*[116] where the seller offered to restore the price and take the goods back. It was held that the buyer should have accepted the offer to mitigate his loss.

An important issue may arise in relation to Section 2-715 of the UCC. The Section, as aforementioned, seems to apply the principle of mitigation to the recoverability for consequential losses only. So, can the buyer claim that he is not required to accept the buyer's offer to repair the defective goods on the grounds that the mitigation principle

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repaired free of charge. The car was subjected to a number of inspections during the months following its delivery and also to unsuccessful attempts to put it right. Eventually, the buyer lost patience and rejected the car after he had driven it for about 5,500 miles. The Court of Appeal held that the buyer was entitled to reject the defective car.

[113] 1983 Kan. LEXIS 255; 35 UCC Rep. Serv. 1485 (1983). See also *Joc Oil USA, Inc. v. Consolidated Edison Company of New York, Inc.,* 1980 N.Y. Misc. LEXIS 2894 (1980).

[114] 1991 U.S. App. LEXIS 28861; 16 UCC Rep. Serv. 2d 369 (1991).

[115] In this case, the defective goods were supposed to be sent to Germany in order to be rebuilt there.

[116] [1944] KB 579.

does not apply to the recoverability for normal loss? The answer to this question can be found in *Robertson Mfg. Co. v. Jefferson Tile Co.,*[117] where the buyer refused the seller's offer to cure the defect of the goods, it was held that the buyer was not entitled to the additional expenses of installing the defective goods since such expenses could have been avoided by the seller's offer. In view of this judgement, one may point out that the mitigation principle applies under the UCC to all kinds of loss.

7.4 Notice of breach

The condition of notification is commonly applicable under the UCC and the CISG. Under this condition, the buyer cannot claim any remedy for breach of warranty of quality[118] unless he notifies the seller of the breach.[119] Such a rigorous consequence may be relaxed by means stated under the CISG which can be applied in special circumstances stated below.

Under the SGA, the seller's defence of lack of proper notification is not available in cases where the buyer claims damages for non-conformity of goods. The requirement of notification, under the SGA, is restricted only to cases where the buyer chooses to reject the goods. In this case, the buyer is required to intimate to the seller that he has rejected the goods within a reasonable time after the goods were actually handed over to him.[120] The reasonable time here should be enough to let the buyer have a reasonable opportunity to examine the goods.[121] As the subject matter of this work is concerned with the remedy of damages, the following work will be mostly concerned with the notice requirement under the CISG and the UCC.

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[117] 5 UCC Rep. Serv. 119.

[118] Cases concerning non-conformity, other than defective quality, may be examined in this work since the requirement of notification applies similarly to all kinds of non-conformity of goods.

[119] The requirement of notification is not a legal obligation which can be a ground for a seller's claim of damages in cases where such an obligation is not fulfilled. Neither Article 39 of the Convention nor Section 2-607(3) of the UCC provides that the buyer is legally obligated to give a notice of non-conformity. The buyer will lose his right to rely on any remedy for breach of contract if he does not notify the seller.

[120] Section 35(4) states "The buyer is... deemed to have accepted the goods when after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them."

Section 2-607(3) of the UCC states

> "Where a tender has been accepted... the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy..."

Article 39(1) of the CISG states

> "(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it."

In comparing English law with the UCC and the CISG, it is worth noting that the notice of breach may be of great significance to the seller even in cases where the buyer's claim is only for damages. In fact, the notice requirement is in the interest of the seller since it gives the seller an earlier opportunity to prepare his evidence and defences against the buyer. The seller may also have recourse to his supplier as soon as he becomes aware of the defect of the goods. Besides, the seller may also have the chance to examine the goods in order to make his own decision about the nature of non-conformity.[122] Therefore, it is desirable to adopt the requirement of notification in English law.

It is submitted that the requirement of notification, as stated under the UCC and the CISG, should be adopted under English law provided that the period of notification is wide enough to give the buyer a chance to notify the seller of the non-conformity of goods. The period of notification should be decided under the circumstances of each case. This work will show that some legal systems require the buyer to notify the seller of the non-conformity of goods within a short period after the discovery of the non-conformity. Under such legal systems, the short period of notification was decided, in certain cases, to be one or two days. It does not seem fair that the buyer will lose his

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[121] Section 35(5) of the SGA states "The questions that are material in determining for the purposes of subsection (4) above whether a reasonable time has elapsed include whether the buyer has had a reasonable opportunity of examining the goods..."

[122] See JJ. Phillips, 'Notice of Breach in Sales and Strict Tort Liability Law: Should there be a Difference?' (1971) 47 *Ind. L.J.* 457, 466. Comment 4 to Article 37 of the *Comments on the 1978 Draft of the International Sale of Goods Convention* [Article 39 of the CISG] provides that "The purpose of the notice is to inform the seller what he must do to remedy the lack of conformity, to give him the basis on which to conduct his own examination of the goods, and in general to gather evidence for use in any dispute with the buyer over the alleged lack of conformity...". In case of remedies, other than damages, such a notice can be in the interest of both parties. For example, where the buyer asks for cure of defect or replacement of goods, the notice will make such a cure swifter which is in the interest of the buyer. By giving a notice specifying the nature of the defect, the seller will have a better chance to cure the defects.

right, if he does not notify the seller of the non-conformity within a reasonable time. Therefore, it is submitted that the notice requirement should apply in cases where the buyer claims damages provided that such a period is wide enough to give the buyer the chance to make such a notification.

7.4.1 Who is Required to Notify?

Explicitly, Section 2-607(3) of the UCC and Article 39 of the CISG provide that the buyer is the person who is required to notify the seller of the breach. However, the requirement of notification would likely be fulfilled if one of the buyer's employees notified the seller of the non-conformity. In fact, the question about the source of notification is not significant where the actual awareness of the seller is proved or not questioned. The question may become considerably more important where the seller denies his receipt of notification. In this case, the buyer needs to prove that he has given the notice by using the appropriate means.[123] Section 1-201(26) of the UCC makes it clear that the buyer can notify the seller "by taking such steps as may be reasonably required to inform the [seller] in ordinary course whether or not such [a seller] comes to know of it...". Article 27 of the CISG states a similar way of notification.[124] Nevertheless, the buyer cannot rely on his own presumption that a third party has notified the seller. If this becomes the case, the buyer may be required to show evidence that the seller was actually notified.

However, does this apply to a third party's claim? This question possibly arises under the UCC since Section 2-318 extends the seller's implied or express warranties to beneficiaries, other than the direct buyer. Such an extension of warranty does not exist

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[123] In cases of termination of contract, Section 2-309 of the UCC requires, for the termination of contract by one party, a reasonable notification be received by the other party. Section 2-309(3) provides "Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable." As for the definition of "receive" Section 1-201(26) of the UCC states that "... A person "receives" a notice or notification when (a) it comes to his hand or his attention; or (b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications." In this sense, where the buyer chooses to reject the goods and terminate the contract, he has to notify the seller of the termination and to make sure that the seller received the notification.

[124] Article 27 of the CISG states that "... if any notice, request or other communication is given or made by a party in accordance with this part and by means appropriate in the circumstances, a delay or error in the transmission of the communication or its failure to arrive does not deprive that party of the right to rely on the communication."

under either the CISG or the SGA.[125] It should be plain that Section 2-607(3) of the UCC is only concerned with the duty of the *buyer* to issue such a notice within a reasonable time after acceptance. Unfortunately, the official comment to this Section does not give a clear-cut answer to this issue. Comment 5 states that "... a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred... but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation". In this sense, a great deal is left to the court to decide whether the beneficiary acted in a good faith or not. Here, the seller should prove that the beneficiary has acted in bad faith by not giving him a proper notification of the non-conformity of goods.

Although comment 5 to Section 2-607(3) states that the third party's claim may be unsuccessful where he fails to give proper notification, American courts do not take a consistent approach towards the applicability of such a comment. In *Western Equipment Co. v. Shedridan Iron Works,*[126] the Supreme Court of Wyoming stated that where the sub-buyer sues the manufacturer for breach of warranty and privity doctrine does not arise,[127] the sub-buyer has to furnish a notice under Section 2-607(3) of the UCC. This is one of the leading cases[128] where the court applied Section 2-607(3) in order to require the third party to notify the seller of the breach. However, this does not seem a settled law. For example, in *Taylor v. American Honda Motor Co.,*[129] where a third party beneficiary claimed damages for personal injury resulting from the manufacturer's breach of warranty of quality, the Court held that Section 2-607(3) applies only where the plaintiff is the buyer.[130] In this case, the Court denied the application of comment 5 to Section 2-607(3) on the ground that the comment seems to be in direct contrast with the unambiguous language of the Section. The Court based its decision on the ground

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[125] Supra, p.258.
[126] 1980 Wyo. LEXIS 230.
[127] See Section 2-318 of the UCC.
[128] See also *Morrow v. New Moon Homes*, Inc., 1976 Alas. LEXIS 377; 19 UCC Rep. Serv. 1 (1976); *Branden v. Gerbie*, 1978 Ill. App. LEXIS 2916; 24 UCC Rep. Serv. 152 (1978).
[129] (1982) U.S. Dist. LEXIS 16765; 35 UCC Rep. Serv. 391. See also *Tomczuk v. Town of Cheshire,* 1965 Conn. Super. LEXIS 179; 3 UCC Rep. Serv. 147 (1965); *Frericks v. General Motors Corp. (No.2),* 1976 Md. LEXIS 632; 20 UCC Rep. Serv. 371 (1976); *Clemco Industries v. Johnson*, 368 So.2d 509 (Ala. 1979).
[130] *Taylor v. American Honda Motor Co.,* 1982 U.S. Dist. LEXIS 16765.

that comments to the provisions of the UCC are not statutory thus the court has a discretion to decide their applicability. A similar conclusion was reached by the Supreme Court of Colorado in *Cooley v. Big Horn Harvestore System, Inc.,*[131] where the ultimate buyers sued the manufacturer for losses resulting from its breach of warranty of quality. The ultimate buyers did not notify the manufacturer of the breach. The Court stated clearly that, unless special circumstances indicate otherwise, the third party is not required to notify the manufacturer of the breach under Section 2-607(3) of the UCC.[132]

Logically, the spirit of Section 2-607(3) and the purpose of notification imply that the third party should notify the seller of the breach once he becomes aware of the legal situation of notification[133] or once he knows that such a notification is significant to the seller although this is not expressly provided by Section 2-607(3). Requiring a stricter standard of such a notification, may deprive a good faith consumer of a remedy; this will be contrary to the purpose of the law.[134] On the other hand, requiring a more flexible standard may offer a bad faith plaintiff more than he is fairly entitled to.

7.4.2 The Content of the Notice

Neither Section 2-607(3) of the UCC nor Article 39 of the CISG requires a specific form of notification. The buyer may notify the seller orally or in writing depending on the circumstances of each case.[135] Means of communication such as normal post, fax, telex and electronic mail, may suffice.[136] However, the buyer should notify the seller by the appropriate means. Here, the buyer is advised to use the means which make the proof of notification easier.[137] For example, notifying the seller via telephone may face the

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[131] 1991 Colo. LEXIS 415; 14 UCC Rep. Serv. 2d 977 (1991). See also *Church of Nativity of our Lord v. WatPro, Inc.,* 1992 Minn. LEXIS 278; 18 UCC Rep. Serv. 2d 1017 (1992); *Vescio v. Chrysler Corp.* 23 UCC Rep. Serv. 659 (Pa. C. P. 1977); *Firestone Tire and Rubber Co. v. Cannon,* Md. LEXIS 221; 34 UCC Rep. Serv. 1564 (It was held that the buyer's action against a remote manufacturer is not barred by the buyer's failure to notify the manufacturer of the breach since Section 2-607(3) requires the buyer to notify his direct seller).

[132] *Cooley v. Big Horn Harvestore System, Inc.,* 1991 Colo. LEXIS 415.

[133] Comment 5 to Section 2-607.

[134] See the decision of the Supreme Court of Colorado in *Cooley v. Big Horn Harvestore System, Inc.,* 1991 Colo. LEXIS 415.

[135] F. Ferrari, 'Recent Developments: CISG: Specific Topics of the CISG in the Light of Judicial Application and Scholarly Writing' (1995) 15 *J. L. & Com.* 1, 112; available at <http://cisgw3.law.pace.edu/cisg/biblio/2ferrari.html>.

[136] P. Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods,* [Translated by G. Thomas], Oxford, 1998, p.313.

[137] See *Arrondissementsrechtsbank 's-Gravenhage (Smits BV v. Jean Quetard)* of 7 June 1995 (Netherland) <http://cisgw3.law.pace.edu/cases/950607n1.html>.

problem of proof in cases where the seller denies his receipt of the notice. In one CISG case, the buyer was required to provide a record of the date of the telephone call and the name of the person who answered the call.[138]

The content of the notice, under the UCC, "need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched".[139] In this sense, the notice may be sufficient enough if it makes it clear that the goods are not in conformity with the contract without specifying the nature of non-conformity.[140] The requirement of more specific notification can be found under Article 39 of the CISG. Comment 4 to Article 37 of the 1978 draft of the CISG (currently Article 39) provides that the notice "must specify the nature of the lack of conformity." In this sense, contrary to the UCC, the notice that does not specify the nature of the lack of conformity will not meet the requirement of notification under Article 39 of the CISG. Such a strict standard meets the need of the international sale. A seller to a domestic sale contract, who is notified of the non-conformity, will presumably be able to examine the goods in question and find out the nature of the lack of conformity whereas a seller to an international sale contract may find it hard to reach the goods in question in order to investigate their non-conformity. It should be clear that the seller needs to be aware of the nature of non-conformity in order to prepare his evidence and defences or to have recourse to his supplier as the case may be.

Implied notification may be accepted by the flexible standard of notification under Section 2-607(3) of the UCC. Where the buyer makes the seller aware of the breach by acts other than formal notification, the notice requirement under Section 2-607(3) may be satisfied.[141] This cannot be the case under the CISG; implied notification is unlikely to be accepted for the purpose of Article 39 of the Convention since the Article makes it clear that the notice must specify the nature of the lack of conformity.

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[138] In *Amtsgericht Kehl* of 6 October 1995 (Germany) <http://cisgw3.law.pace.edu/cases/951006g1.html>, the buyer gave two notices of the non-conformity of the goods received. The first notice was given over the phone immediately after he discovered the defect whereas the second was given later via a fax. The Court did not accept the alleged first notice since there was no proof of the notification. See also *Landgericht Frankfurt* of 13 July 1994 (Germany), <htttp://cisgw3.law.pace.edu/cases/940713g1. html>.

[139] Comment 4 to Section 2-607 of the UCC.

[140] However, the buyer may be required to specify the quantity of the defective goods. See here *Michigan Sugar Co. v. Jebavy Sorenson Orchard Co.* 66 Mich. App. 642 (1976).

[141] See *Boeing Airplane Co. v. O'Malley,* U.S. App. LEXIS 5958; 2 UCC Rep. Serv. 110 (8th Cir. 1964) where the court made it clear that certain acts other than formal written notice may be accepted for the purpose of Section 2-607(3).

Indisputably, the sufficiency of the information, notified to the seller, concerning the nature of non-conformity, can always be decided depending on the circumstances of each case. For example, a buyer who is expert in the type of goods in question may be required to notify the seller of detailed explanation of the lack of conformity; on the other hand, an innocent consumer may not be required to give a notice specifying precisely the lack of conformity. An inexperienced commercial buyer may not have to notify the seller of all the precise details of the non-conformity.[142] Furthermore, in deciding the sufficiency of information notified to the seller, the court may take into account the practice established between the parties and well-known usage. This can be of great significance in international sales where parties to an international sale are bound by well-known usage. In view of this, it can be noted that the notice may be sufficient enough even if it omits some details of the lack of conformity which are reasonably supposed to be known to the seller.[143] However, the buyer cannot ignore material information regarding the lack of conformity on his own presumption that they are known to the seller.[144]

In cases of multiple aspects of non-conformity, should the buyer notify the seller of the nature of each aspect? Comment 4 to Section 2-607 of the UCC makes it clear that "(t)here is no reason to require that the notification... must include a clear statement of all the objections that will be relied on by the buyer...".[145] However, in the case of

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[142] F. Ferrari, supra n.135 at p.112.

[143] Article 9 of the Convention states "(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. (2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned." See, however, *Landgericht Bochum* of 24 January 1996 (Germany) <http://cisgw3.law.pace.edu/cases/960124g1.html> where the buyer notified the seller that the truffles delivered were "soft". The buyer alleged that most professional truffle-vendors would know that softness implies a probable worm-infestation. The Court concluded that the notice did not specify the nature of non-conformity regardless of whether or not it was known to the seller that softness implies a probable worm-infestation. The case is cited in Camilla Baasch Anderson, Reasonable Time in Article 39(1) of the CISG - Is Article 39(1) Truly a Uniform Provision? *Pace Essay Submission,* Sep. 1998, note 127, <http://cisgw3.law.pace.edu/cisg/biblio/anderson.html>.

[144] See *Landgericht Murburg* of 12 December 1995 (Germany) <http://cisgw3.law.pace.edu/cisg/951212g1.html> where the buyer notified the seller of the breach but he did not quote the serial number of the goods in question and their date of delivery. The Court held that the notice is not sufficient on the ground that the seller is not required to look for such information in order to find out the certain defective machine. The case is discussed in A. Veneziano, Non Conformity of Goods in International Sales: A Survey of Current Caselaw on CISG, (1997) 36 *Revue De Droit Des Affaires Internationales* 39, 52.

[145] Under Section 2-605 of the UCC, where the buyer rejects the goods and terminates the contract, he may be required to notify the seller of all of his objections that he will rely on. Section 2-605(1) of the UCC states "The buyer's failure to state in connection with rejection a particular defect which is

instalment contracts, both the UCC[146] and the CISG,[147] require the buyer to give a notice of the non-conformity of each instalment. As for the CISG, the buyer should notify the seller of the nature of each aspect in order to meet the purpose of Article 39(1).[148] If the buyer gives a proper notice of part of these aspects, he may be allowed to rely on this part only for claiming damages from the seller. For example, in the CISG case of *Landgericht Bielefeld*,[149] the Court allowed the buyer to rely on one defect of the goods; i.e. unclean bacon, properly communicated to the seller and disallowed him to rely on another defect, i.e. unsatisfactorily smoked bacon, not specifically communicated to the seller.

7.4.3 The Time of Notification

Section 2-607(3) of the UCC and Article 39 of the CISG make it clear that, unless a contrary agreement indicates otherwise, the buyer will lose his right to rely on any remedy unless he notifies the buyer of the nature of non-conformity within a "reasonable time" after he has discovered or ought to have discovered the non-conformity. Article 39 of the CISG provides a cutoff period where the buyer cannot rely on any remedy after its expiration. However, where the buyer does not notify the seller within the right period under Article 39 of the Convention, the buyer may be able to rely on the remedy of damages in special circumstances discussed below.[150]

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ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach (a) where the seller could have cured it if stated seasonably; or (b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely."

[146] Section 2-612 of the UCC make it clear that the buyer can bring an action for the non-conformity of one instalment. In this sense, the buyer has to notify the seller of the non-conformity of each instalment in question.

[147] P. Schlechtriem, supra n.136 at p.313.

[148] C.B. Anderson, supra n.143 text accompanying note 48.

[149] 18 January 1991 (Germany) <http://cisgw3.law.pace.edu/cases/910118g1.html>. See also *Landgericht Landhut* of 5 April 1995 (Germany) <http://cisgw3.law.pace.edu/cases/950405g1.html> where the buyer purchased sport clothes which suffered three kinds of defects, i.e. colour, shrinkage and wrong quantity, the court rejected the buyer's claim for all the defects since he did not notify the seller of the nature of all the defects. Quoted from C.B. Anderson, supra n.143 text accompanying nn.129, 174.

[150] Infra, p.320.

7.4.3.1 The "Reasonable Time" of Notification

The period of notification commences at the time when the buyer discovers or ought to discover the non-conformity.[151] As for the former, the period of notification commences at the time when the buyer becomes aware of the non-conformity *in fact*. Therefore, where the buyer discovers the non-conformity by the time of handing over the goods, the period of notification commences at the time of discovery.[152] Similarly, where the transport document reveals that goods were externally defective when they were handed over to the carrier, the period of notification commences at the time of receiving such a document since at that time the buyer becomes actually aware of the lack of conformity.[153]

The period of notification commences also at the time when the buyer ought to discover the non-conformity regardless of whether the buyer was actually aware of non-conformity or not. In this sense, where a reasonable examination[154] can reveal the nature of non-conformity, the period of notification starts at the time of the proper examination or at the time when the buyer was supposed to examine the goods. So, when the buyer does not examine the goods, the reasonable period of notification starts at the end of the period of examination.[155] This applies only to defects which can be revealed by a

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[151] The Secretary Commentary does not provide a definition for the "reasonable time" stated under Article 37(1) (former draft of Article 39(1)) nor does it provide a guideline for determining such a "reasonable time". Likewise, Section 2-607 of the UCC provides no guideline for measuring the "reasonable time" of notification. Apparently, the drafters were inclined to state a flexible expression which can be interpreted according to the circumstances of each case. See *Economy Forms Corp. v. Kandy Corp.* 511 F.2d 1400 (5th Cir. 1975). For cases of untimely notices under the UCC see the follows. *Pace v. Sagebrush Sales Co.* 560 P.2d 789 (Ariz. 1977); *Branden v. Gerbie* 1978 Ill. App. LEXIS 2916; 24 UCC Rep. Serv. 152 (1978).

[152] F. Enderlein and D. Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods: Convention on the Limitation Period in the International Sale of Goods*, New York, 1992, p.160.

[153] P. Schlechtriem, supra n.136 at p.307.

[154] The examination should be done within a reasonable time in accordance with Article 38 of the CISG and Section 2-513(1) of the UCC. As for the period of examination, Article 38 of the CISG states "(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances. (2) If the contract involves carriage of goods, examination may be deferred until after the goods have arrived at their destination. (3) If the goods are redirected in transit or redispatched by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redirection or redispatched, examination may be deferred until after the goods have arrived at the new destination."

[155] As for the measurement of the period of examination, Article 38 of the CISG states several situations where the commencement of the period of examination varies from one to another. Part one of the Article deals with contracts which do not involve carriage of goods. In this case, the period of examination commences at the time when the goods are handed over to the buyer. Where the seller delivers the goods before the stipulated time of delivery, i.e. premature delivery, the time of examination commences at the stipulated time of delivery unless it has been agreed on such an early delivery. See P. Schlechtriem, supra n.136 at p.306. Furthermore, in special circumstances, the buyer may not be able to examine the goods due to some impediments such as a general strike or technical operating instructions have not arrived. If

reasonable examination.[156] However, in cases of latent defects, which cannot be revealed by a reasonable examination, the period starts at the time when the buyer becomes, or ought to be, aware of the defect.[157] Where the reasonable use of goods can reveal their defect, the buyer should notify the seller within a reasonable time after putting the goods to use. In such a case, the reasonable time of notification commences at the time when the buyer has an opportunity to discover the non-conformity of goods.[158]

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this becomes the case, the period of examination commences at the time when the buyer has a reasonable opportunity to examine the goods. Acceptable impediments, for this purpose, should be objective; in other words, personal impediments related to the buyer or one of his employees are unlikely accepted. In cases where the contract of sale involves carriage of goods, part two of Article 38 makes it clear that the period of notification commences at the time when the goods arrive to their destination. Here, it should be noted that parties to an international sale, which involves carriage of goods, should include in their contract the destination of the transportation. Destination under CIF and FOB contract is the port of destination whereas under other contracts it is the place of the business of the buyer or his sub-buyer where the goods are dispatched directly to him. Part three of the Article postpones the examination of the goods to their new destination where they are redirected or redispatched by the buyer. Here it is irrelevant whether the buyer or his sub-buyer redirected or redispatched the goods in question. Such a postponement of examination is subject to two conditions, i.e. the redirection or redispatch of the goods was known or ought to have been known to the seller at the time of the conclusion of contract and the buyer had no reasonable opportunity to examine the goods. As for the former, it is clear that where the seller was not aware or ought to have been aware, at the time of making the contract, of the resale of goods which involve redispatch or redirection, the examination cannot be postponed to the time of their arrival to their new destination. This may not be the case where the buyer cannot examine the goods due to an impossibility of handing over the goods at the original destination. In this case, the examination may be postponed until after they arrive at a new destination regardless of whether the seller was aware or ought to have been aware of such a redirection. As for the latter, the question of whether or not the buyer had a reasonable opportunity to examine the goods depends on the nature of the goods and on how long the buyer had the goods before they were redispatched. For example, where the examination of the goods makes them unsuitable for a subsequent carriage, the buyer will not be considered as having a reasonable opportunity of examination. See C.M. Bianca, in Bianca and Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention,* Milan, 1987, pp.302, 300.

[156] See *S.M. Wilson and Co. v. Reeves Red-E-Mix Concrete, Inc.* 350 N.E.2d 321 (III. App. 1976). As regards the period of examination under the UCC, Section 2-513 of the UCC provides that "Unless otherwise agreed... where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival." Unlike the CISG, the Section does not deal specifically with the time of examination in cases where the goods are redirected or redispatched. The Section leaves a great deal to the court to decide what time and place of examination can be reasonable. Comment 3 to the Section provides that "the reasonableness will be determined by trade usage, past practices between the parties and the other circumstances of the case."

[157] C.M. Bianca, in Bianca and Bonell, supra n.155 at p.298. See the UCC case of *Murray v. Kleen Leen, Inc.* 41 III. App. 3d. 436 (1976).

[158] In *Landgericht Düsseldorf* of 23 June 1994, decided in Germany, <http://cisgw3.law.pace.edu/cases/940623g1.html> where the period of examination of two low power engines purchased in order to be used in the manufacture of hydraulic presses and welding machines, the period was two long and as a result the Court found that the buyer did not notify the seller in a reasonable time. In this case, the buyer was not granted any remedy. This case is discussed in A. Veneziano, supra n.144 at p.50.

The period of notification can be affected by several factors.[159] Discernibility of defects is one of the main factors which affect the period of examination and, as a result, affect the beginning of the period of notification. The discernability of non-conformity depends mostly on the nature of goods; for example, where the goods are technological machinery, the period of examination will presumably be longer than in the case where the goods are consumable such as fruit and vegetables. The fact that the goods are perishable or durable can be an important factor for determining the reasonable period of examination. The examination period in cases of perishable goods is probably shorter than in cases of durable goods.[160] This can be understandable on the ground that the situation of perishable goods worsens rapidly and, thus, the seller needs to know their defect as early as possible in order to mitigate, if it is possible, their deterioration.[161] Furthermore, the discernability of defects depends also on the nature of the parties. A buyer who is not expert in the goods, may not be expected to discover the defect of the goods in a short period; the same would apply to the buyer who neither has nor has available the technical facilities and expertise.[162]

7.4.3.2 The Influence of Domestic Laws

The court, in applying Article 39 of the Convention, has to take into account the international aspect of the Convention in accordance to Article 7(1).[163] However, in practice, the application of Article 39 is highly influenced by domestic laws. The

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[159] The choice of claim may have a considerable impact in determining the "reasonable time" of notification. The period of notification, in cases where the buyer asks for repair or replacement or where he rejects the goods and avoid the contract, is likely to be longer than where the buyer retains the goods subject to his claim of damages. In cases where the buyer rejects the goods, it is probably in the seller's interest to be notified of the breach swiftly in order to be prepared to deal with the goods in question and not only with the buyer's claim. The seller will need in this case to market the rejected goods in order to find a substitute buyer. In cases where the buyer asks for repair, it is in the seller's interest to cure the goods before their situation becomes worse and, of course, it is in the buyer's interest to have a swift repair of the goods in question. As the subject matter of this work is the remedy of damages, factors are examined insofar as its effect on the period of notification where damages is the only remedy claimed, i.e. where the buyer retains the goods and claim damages.

[160] Similarly, in cases of seasonal goods, where the buyer wants to avoid the contract, it will be in the reasonable interest of the seller to be notified of the breach in order to market the goods in question before their season passes and as a result their price drops sharply.

[161] If the buyer can reasonably stop the deterioration of the goods in question, he will be required to do so under the mitigation principle.

[162] Comment 3 to Article 38 of the CISG provides that "... a party would not be expected to discover a lack of conformity of the goods if he neither had nor had available the necessary technical facilities and expertise, even though other buyers in a different situation might be expected to discover such a lack of conformity." UN Doc.A/CONF.97/5 Secretariat Commentary to Article 36 of the 1978 draft of the CISG (currently Article 38 of the CISG).

influence of domestic laws on the notice requirement under the CISG can be noticed in two aspects, i.e. the content of the proper notice and the determination of the "reasonable time" of notification.

The interesting survey of Anderson on the practice of the European courts in relation to Article 39 of the CISG shows that the application of Article 39 is highly influenced by domestic laws.[164] As for the influence on the content of notification, the German courts, as an example, require the notice to provide precise details of the nature of non-conformity. This is probably due to the influence of the notice requirement under the Germanic legal system. For example, in *Landgericht München*,[165] where a German buyer claimed damages from an Italian seller who delivered defective fashion goods, the Court rejected the buyer's claim reasoning that of the lack of proper notice in accordance with Article 39(1) of the CISG. In this case, the buyer notified the seller of poor workmanship and improper fitting of the goods. The court held that such a notice did not specify the nature of non-conformity for the purpose of Article 39(1) since the purpose of the notice requirement under this Article is to clarify the nature of complaint. The American UCC, as another example, has a flexible standard concerning the requirement of notification as explained above.[166] Here, it would not be surprising if the American courts were influenced by such a flexible standard in the application of Article 39 of the CISG.

As regards the influence on the period of notification, the practice of courts across the European continent shows that there is no coherent attitude towards measuring the period of notification under Article 39 of the CISG. This is due to the influence of the different periods of notification among the several domestic laws. Whereas the German domestic law[167] requires the notification to be within a short period, the French Civil Code[168] allows such a notification to be with a brief delay. Furthermore, some other

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[163] Article 7(1) of the CISG states "In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade."

[164] C.B.Anderson, supra n.143.

[165] 3 July 1989 (Germany) <http://cisgw3.law.pace.edu/cases/890703g1.html>.

[166] The notification of poor workmanship and improper fitting of the goods is likely to meet the purpose of Section 2-607(3) of the UCC. See Larry A. DiMatteo, 'the CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Dealings' (1997) 22 *Yale J. Int'l L.* 111, 163-164.

[167] See Article 377 of the German HGB (German Sales Law).

[168] See Article 1648 of the French Civil Code. Cases decided in France show that the period of notification is approximately one month. See, for example, *Cour d'Appel de Grenoble* of 13 September

domestic laws require such a notification to be immediately[169] or within a specific period[170] after the discovery of non-conformity. Here, one cannot ignore the American flexibility in applying the reasonableness test to the period of notification, especially in consumer contracts.[171]

The measurement of the period of notification may also vary from a case to another in the one country where the "rule of precedent" does not exist; this can be found under the civil legal system. The interesting survey of Anderson[172] shows that although the German Supreme Court[173] made it clear that a period of one month after the discovery of non-conformity is reasonable due to different international legal traditions, many subsequent cases were decided differently.[174]

1995 <http://cisgw3.law.pace.edu/cases/950913f1.html> where a notice given one month after delivery was considered timely.

[169] See Article 370(3) of the Swiss Federal Code of Obligations. Probably, due to the influence of the Swiss domestic law, a notice given four weeks after delivery was considered untimely under Article 39(1) of the CISG; see here *Handelsgericht Züricht* of 26 April 1995 <http://cisgw3.law.pace.edu/cases/950426s1.html>.

[170] See Article 1495 of the Italian Civil Code where the periof of notification is limited to eight days after the discovery of non-conformity.

[171] Comment 4 to Section 2-607 of the UCC states "The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy." See *G and D Poultry Farms, Inc. v. Long Island Butter and Egg Co.,* 306 N.Y.S. 2d (App. Div. 1969); *Leeper v. Banks* 487 S.W.2d 58 (Ky. 1972); *Metro Inv. Corp. v. Portland Road Lumber Yard, Inc.* 501 P.2d 312 (Ore 1972); *United States Fid. and Guar. Co. v. North Am.. Steel Corp.* 335 Sso.2d 18 (Fla. Dist. Ct. App. 1976); *Tarter v. Monark Boat Co.* 430 F. Supp. 1290 (E.D. Mo. 1977).

[172] C.B.Anderson, supra n.143.

[173] See *The German Supreme Court (Bundesgerichthof)* of 8 March 1995 <http://cisgw3.law.pace.edu/cases/950308g3.html>. See the following German cases decided prior to the mentioned decision of the Supreme Court. *Oberlandesgericht Düsseldorf* of 8 January 1993 <http://cisgw3.law.pace.edu/cases/930108g1.html> (notice given 7 days after the examination was considered untimely); *Amtsgericht Riedlingen* of 21 October 1994 <http://cisgw3.law.pace.edu/cases/941021g1.html> (notice given 21 days after delivery was considered untimely; *Landgericht Frankfurt am Main* of 9 December 1992 <http://cisgw3.law.pace.edu/cases/921209g1.html> (notice given 19 days after delivery was considered untimely); *Landgericht Aachen of* 3 April 1990 <http://cisgw3.law.pace.edu/cases/900403g1.html> (notice given 1 day after delivery was considered timely); *Landgericht Bielefeld* of 18 January 1991 <http://cisgw3.law.pace.edu/cases/910118g1.html> (notice given 3 days after discovery of non-conformity was considered timely); *Landgericht Berlin* of 16 September 1992 <http://cisgw3.law. pace.edu/cases/920916g1.html> (notice given two months after delivery was considered untimely); *Landgericht Berlin* of 30 September 1992 <http://cisgw3.law.pace.edu/cases/ 920930g1.html> (notice given three and a half months after delivery was considered untimely); *Oberlandesgericht Saarbrücken* of 13 January 1993 <http://cisgw3.law.pace.edu/cases/930113g1.html> (notice given two months after delivery was considered untimely); *Landesgericht Düsseldorf* of 23 June 1994 <http://cisgw3.law.pace.edu/cases/940623g1.html> (notice given two months after delivery was considered untimely). For more cases decided before the mentioned decision of the Supreme Court, see M. Karollus, 'Judicial Interpretation and Application of the CISG in Germany 1988-1994' (1995) *Cornell Review of the Convention on Contracts for the International Sale of Goods* 51; available at <http://cisgw3.law.pace.edu/cisg/biblio/karollus. html>.

[174] See the following German cases where the period of notification was less than one month: *Landgericht Landhut* of 5 April 1995 <http://cisgw3.law.pace.edu/cases/950405g1.html>; *Landgericht Heidelberg* of 2 October 1996 <http://cisgw3.law.pace.edu/cases/961002g1.html>. However, see the following German

The court, in applying the CISG, should always examine relevant international cases decided in other countries in order to avoid disparities in the case law of the CISG signator countries.[175] The uniformity in application can best be done by examining cases decided by International Arbitral Tribunals since such decisions are less influenced by domestic laws. Cases decided by the ICC International Court of Arbitration show that the period of notification is one month unless special circumstances indicate otherwise.[176]

Due to the lack of a consistent approach towards the measurement of the period of notification, it is submitted that the month period, provided by the ICC International Court of Arbitration, should be considered as a guideline to be applied in normal circumstances. Even in special circumstances, e.g. easily discernible defect, the guideline can be the starting point for deciding the reasonableness of longer or shorter period of notification.

7.4.3.3 The Cutoff Period of Notification: Article 39(2) of the CISG

Article 39(2) of the CISG states

> "In any event, the buyer loses the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof at the latest within a period of two years from the date on which the goods were actually handed over to the buyer, unless this time-limit is inconsistent with a contractual period of guarantee."

As the "reasonable time" of notification starts to run at the time when the buyer discovers or ought to discover the defect, the seller's liability, without Article 39(2) or

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cases which considered the month period of notification provided by the Supreme Court: *Oberlandesgericht Stuttgart* of 21 August 1995 <http://cisgw3.law.pace.edu/cases/950821g1. html>; *Amtsgericht Augsburg* of 29 January 1996 <http://cisgw3.law.pace.edu/cases/960129g1.html>.

[175] See C. Witz, *The Interpretive Challange to Uniformity,* Paris, 1995, reviewed by V.G. Curran, (1995) 15 *J. L. & Com.* 175, 198.

[176] See the following cases decided by the International Arbitral Tribunal. *ICC Arbitration Case No.7331 of 1994* <http://cisgw3.law.pace.edu/cases/947331i1.html> (notice given one month after delivery was considered timely); ICC Arbitration Case No. 5713 of 1989 <http://cisgw3.law.pace.edu/ cases/895713i1.html> (notice given eight days after the publication of an expert report was considered timely). See also *Hungary 5 December 1995 Budapest Arbitration Proceeding Vb94131* <http://cisgw3. law.pace.edu/cases/951205h1.html> (notice given thirty two days after delivery was considered untimely). Cited in C.B.Anderson, supra n.143.

limitation period under domestic laws, could be open ended.[177] Clearly, Article 39(2) denies the buyer's reliance on any remedy unless he gives a notice to the seller specifying the nature of non-conformity within two years from the time of handing over the goods. Two main issues may arise out of the application of Article 39(2), i.e. where the period of guarantee is longer or shorter than two years and where the limitation period of claims, under the applicable law, is longer or shorter than two years.

The issue of the period of guarantee can be decided in relation to the kind of rights that the guarantee deals with. Guarantees may be designed to replace the buyer's rights under the Convention or to add rights in addition to those provided by the Convention. As for the former, the cutoff period will be the period of guarantee regardless of whether it is longer or shorter than two years since this will be a kind of derogation of Article 39(2) of the Convention. As regards the latter kind of guarantee, determining the cutoff period depends on the cause of the buyer's loss. While the period of guarantee applies where the loss results from its breach, the two years period under Article 39(2) of the Convention applies where the loss results from breach of implied warranty provided by the Convention.[178] It should be noted that the period of guarantee, in the absence of a contrary agreement, has no effect on the application of Article 39(1): that is to say that the buyer cannot wait till the end of the period of guarantee if the "reasonable time" of notification, under Article 39(1) of the CISG, expires before that.[179]

The buyer's claim for the seller's breach may be limited by a specific period of time stated in domestic law or the Convention on the Limitation Period in the International Sale of Goods (henceforth "the Limitation Convention") as the case may be. The Limitation Convention makes such a period four years from the time when the goods are actually handed over to the buyer;[180] the UCC, as an example on domestic laws,[181]

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[177] R. Hyland, *Commentary on ICC Arbitration Case No.5713 of 1989,* available at <http://cisgw3.law.pace.edu/cases/895713i1.html>, text accompanying note 35.
[178] F. Enderlein and D. Maskow, supra n.152 at p.162.
[179] P. Schlechtriem, supra n.136 at p.317.
[180] See Article 8 of the Limitation Convention.
[181] As for the period of limitation under English law, Section 5 of the Limitation Act 1980 provides "An action founded on simple contracts shall not be brought after the expiration of six years from the date on which the cause of action accrued." However, under Section 11 the period of limitation in case of actions based on personal injuries, is three years from "the date on which the cause of action accrued; or ... the date of knowledge (if later) of the person injured." Although the CISG does not apply to claims based on personal injuries, the buyer may be able to sue under the CISG to recover indemnity paid or payable to a sub-buyer for personal injury resulting from the seller's breach of warranty of quality. Therefore, the buyer would not be able to recover for his liability to the sub-buyer if he was found liable two years after

makes such a period four years from the time when the tender of delivery is made.[182] In view of that, where the goods appear defective after more than two years, the buyer's claim, under the CISG, may not be successful although it may be allowed under the applicable domestic law or the Limitation Convention. Similarly, where the buyer is found liable to a sub-buyer, who found the goods defective after more than two years from the time when the goods were actually handed over to the buyer, the buyer's claim against the seller for his liability to such a sub-buyer may not be successful due to the expiration of the two year cutoff period under Article 39(2) of the CISG.[183] On the other hand, where the buyer's claim is limited by a period of time less than two years under the applicable domestic law, e.g. the Italian law,[184] the buyer's claim will be disallowed although it is within the cutoff period under Article 39(2) of the CISG. In light of such an inconsistency between the cutoff period of notification under the CISG and the limitation period of claims, whether under the applicable domestic law or the Limitation Convention, parties are strongly advised to agree on a limitation period at the time of making the contract.

7.4.4 Means of Relaxation of the Notice Requirement

As Article 39 states a rigorous consequence of the buyer's failure to give notice, Articles 40 and 44 of the Convention take a lenient approach by denying the applicability of Article 39 in certain situations, i.e., derogation of the requirement of notification, reasonable excuse for the lack of proper notification and, finally, the seller's awareness of non-conformity.

7.4.4.1 Derogation of the Requirement of Notification

Article 6 of the Convention[185] allows the parties to derogate from or vary the effect of Article 39 by agreeing on a different time frame of notification.[186] Similarly, Section 1-

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the goods were actually handed over to him. For further information about the limitation period under English law see J.F. Josling, *Periods of Limitation,* London, 7th ed., 1989; A. McGee, *Limitation Periods,* 1990.

[182] See Section 2-725 of the UCC. See O. Gonzalez, 'Remedies under the U.N. Convention for the International Sale of Goods' (1984) 2 *Int'l Tax & Bus. Law.* 79, 90.

[183] F. Ferrari, supra n.135 at p.111.

[184] Article 1495(3) of the Civil Code of Italy limits the buyer's claim to one year from the time when the goods are handed over.

[185] Article 6 of the CISG states "The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.

204 of the UCC allows the parties to agree on a fixed period of time of notification.[187] Furthermore, parties may agree to exclude the application of a notice requirement and, as a result, waive the seller's defence of the lack of proper notification.[188] Such a derogation or exclusion should be made by an agreement between the parties according to Article 6 of the Convention and, thus, cannot be understood by the conduct of one party. However, the application of Article 39 can also be denied by a trade usage under Article 9(2)[189] of the Convention unless an express term in the contract indicates otherwise.[190] Under Article 9(2) of the Convention, trade usage may apply to the contract.

It is worth adding that the seller may lose his right to rely on the lack of proper notification if he informs the buyer that the notice of non-conformity is sufficient for the purpose of Article 39. Furthermore, the seller will be stopped from relying on the lack of proper notification if he gives the buyer reason to believe that he considered the claim justified despite the improper notification.[191] It should be clear that the buyer's own impression that the seller has accepted the notice will not be enough for denying the seller his right to raise the defence of the lack of proper notification under Article 39 of the Convention. For example, where the seller asks for more information about the nature of non-conformity or about the complaint of a sub-purchaser, the buyer will not

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[186] Agreed time frames were approved by the German courts in many cases such as *Oberlandesgericht München* of 11 March 1998 <http://cisgw3.law.pace.edu/cases/980311g1.html> (time frame was two weeks); *Landgericht Baden-Baden* of 14 August 1991 <http:cisgw3.law.pace.edu/cases/910814g1.html> (time frame was 30 days); *Landgericht Hannover of* 1 December 1993 <http://cisgw3.law.pace.edu/cases/931201g1.html>. Cited in C.B.Anderson, supra n.143 at section 1.3.1.

[187] See *Smart v. Tidwell Industries, Inc.* 668 S.W.2d 605 (Mo. App. 1984).

[188] The effectiveness of such an agreement, under the CISG, is goverened by the applicable domestic law since Article 4(a) excludes the applicability of the Convention to "the validity of the contract...". Clauses specify a time frame for the notification are likely to be reasonable, and as a result valid, if the non-conformity is discoverable within the time-frame. This conclusion can be found in the ICC Arbitration Case No.7331 of 1994 <http://cisgw3.law.pace.edu/cases/947331i1.html> where the time frame of month was upheld on the ground that the defect of the goods was readily ascertained. As for the UCC, such an agreement is governed by Section 2-302 which renders any clause invalid where the court finds it unconscionable. See here *Vandenberg and Sons, N.V. v. Sister*, 2 UCC Rep. Serv. (1964).

[189] Article 9(2) of the CISG. Supra, n.143.

[190] A. Veneziano, supra n.144 at p.53. See also S. Bainbridge, 'Trade Usage in International Sales of Goods: An Analysis of 1964 and 1980 Sales Conventions' (1984) 24 *Va. J. Int'l L.* 619; available at <http://cisgw3.law.pace.edu/cisg/biblio/bainbridge.html> section II.C.2.

[191] See *Austria 15 June 1994 Vienna Arbitration Proceeding SCH-4318* <http://cisgw3.law.pace.edu/cases/940615a4.html>. There are no available cases on this point under the UCC; however, the same conclusion would apply since the seller, who indicated to the buyer that the notice is sufficient, will act in a bad faith if he raises the defence of the lack of proper notice.

lose his right to raise the defence of lack of proper notification. This also applies to cases where the seller tries to settle the dispute by negotiation.[192]

7.4.4.2 Reasonable Excuse for the Lack of Proper Notification

In accordance to Article 44 of the convention, the buyer can reduce the price or claim damages where he has a reasonable excuse for his failure to give the required notice. Such a provision cannot be found under the UCC. However, where an inexperienced or consumer buyer has an excuse for his delay in giving notice, the American court, in determining the reasonable time of notification, may take the excuse into account.

Article 44 of the CISG states

> "Notwithstanding the provisions of paragraph (1) of Article 39 and paragraph (1) of Article 43, the buyer may reduce the price in accordance with Article 50 or claim damages, except for loss of profit, if he has a reasonable excuse for his failure to give the required notice"

Plainly, Article 44 is concerned with the buyer's failure to give notice within the time limit of notification stated under Article 39(2): that is to say that the buyer may reasonably be excused for his failure to give a proper notice if he brings the claim for damages within two years from the time of handing over the goods to the buyer.

The historical draft of this Article shows that the Article was merely a compromise between the view of delegates from developing and developed countries. The former considered the obligation of notification under Article 39 unfair, due to the technological gap between developing and industrialized countries. The lack of specialist knowledge of technical goods and the unfamiliarity of some domestic legal systems with the requirement of such a notice are the main reasons for the existence of this Article.[193]

Certain cases, whereby the buyer can be excused for not giving the required notice, can hardly be put in an exhaustive list. These cases are likely to be concerned with the type of the buyer. This is because this Article is based on equitable consideration of less

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[192] See *Oberlandesgericht Düsseldorf* of 12 March 1993 (Germany) <http://cisgw3.law.pace.edu/cases/930312g1.html> Cited in A. Veneziano, supra n.144 at p.56.

[193] J. Lookofsky, 'Cross-References and Editorial Analysis-Article 44' available at <http://cisgw3.law.pace.edu/cisg/text/cross/cross-44.html>. See also P. Schlechtriem, supra n.136 at p.349.

sophisticated buyers who do not have long experience in trade or who run small businesses especially in developing countries. This has been acknowledged by a CISG case decided by *Oberlandesgericht München,*[194] where the Court made it clear that the buyer, who was a large company, cannot be excused for its failure to give the required notice. Here, the inexperienced buyer can be excused on, at least, two grounds, i.e. he may need a longer time for examining the goods and/or he may not be able to give a notice specifying the nature of non-conformity. Nonetheless, an experienced buyer may also have a chance to be excused in cases where the delay of notification is too short. Here the buyer would be in a better position if the notice was not of a considerable significance to the seller.[195] However, the court will be anxious to excuse such a buyer since the history of the draft of Article 44 makes it clear that the Article is concerned with unsophisticated buyers whose businesses are based in developing countries.[196]

The excused buyer under Article 44 may be entitled to recover for diminution in value of the goods sold and for any consequential loss, except loss of profit, resulting from the seller's breach of warranty. Expressly, the Article denies the recoverability for loss of profit even in cases where such a recovery meets the restrictions imposed on the remedy of damages. Such a denial is probably due to the historical draft of the Article. As previously mentioned, the Article is intended to be in favour of buyers from developing countries who may find the required notification troublesome. However, drafters were reluctant to allow the buyer to recover for loss of profit since such an loss will unpredictably increase the liability of the seller who is originally excused from liability due to the lack of proper notification.

7.4.4.3 The Seller's Actual Awareness of the Defect

Article 40 of the CISG states

> "The seller is not entitled to rely on the provisions of articles 38 and 39 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer"[197]

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[194] 8 February 1995 (Germany) <http://cisgw3.law.pace.edu/cases/950208g1.html>. Cited in A. Veneziano, supra n.144 at p.54.

[195] P. Schlechtriem, supra n.136 at p.351.

[196] See *Oberlandesgericht Saarbrücken* of 13 January 1993 (Germany) <http://cisgw3.law.pace.edu/cases/930113g1.html>, where the buyer's excuse that the he found difficulties in examining the goods was not satisfactory. Cited in A. Veneziano, supra n.144 at n.66.

[197] For the application of Article 40 of the CISG see *Landdericht Trier* of 12 October 1995 (Germany) <http://cisgw3.law.pace.edu/cases/951012g1.html> (where a German buyer did not give a proper notice in accordance to Article 39 of the CISG, the court held that he did lose his rights against the Italian wine

Logically, where the seller is aware of the non-conformity of goods, whether under the UCC[198] or the CISG, it seems senseless to require the buyer to give notice of such a non-conformity.[199] However, in the UCC case of *Eastern Airlines, Inc. v. McDonnell Douglas Corp.*,[200] where the buyer did not give a proper notice of the breach which is known to the seller, the Court decided that "it is not enough under section 2-607 that a seller has knowledge of the facts constituting a nonconforming tender; the Court added that the seller must be informed that the buyer considers him to be in breach of the contract."[201] The Court based its decision on the ground that the seller might have been able to settle the dispute had he become aware of the buyer's view concerning the breach. In fact, the purpose of the notice is to make the seller aware of the breach and not to make him aware of the buyer's claim.[202] Raising the defence that there could be a settlement if the seller was aware of the buyer's opinion about the breach, does not seem enough to deny the buyer his rights claimed.

Article 40 goes further to deny the seller's reliance on the lack of notification where he could not have been unaware of facts that the non-conformity relates to. For example, a manufacturer, or one of his employees,[203] is expected to know about defects which can be discovered by a superficial check or standard test.[204] A dealer, who has been notified of the non-conformity of goods that he has sold from a large lot, should be aware that the rest of the items, sold from the same lot, are defective.[205] Some commentators go further to suggest that the seller should reasonably investigate the goods for the purpose of Article 40.[206] In fact, Article 40 can only be interpreted insofar as facts of which the seller was aware or could not have been unaware: that is to say that "an obligation based

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seller since the latter could not have been unaware of the unmerchantable wine sold.). See also *Arrondissementsrechtbank Roermond (Fallini Stefano & Co. S.N.C. v. Foodik BV)* (Netherland) of 19 December 1991 (Netherland) <http://cisgw3.law.pace.edu/cases/911219n1.html>; ICC Arbitration Case No.5713 of 1989 <http://cisgw3.law.pace.edu/cases/895713i1.html>.

[198] A similar provision to Article 40 of the CISG cannot be found under the UCC.

[199] See *Oberlandesgericht Köln* of 21 May 1996 (Germany) <http://cisgw3.law.pace.edu/cases/960521g1.html> where the seller sold a second hand car with false specification that he was aware of, the court allowed the buyer damages for his liability to his subuyer of the car in question.

[200] 532 F.2d 957 (5th Cir. 1976).

[201] *Eastern Airlines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957 at p.973 (5th Cir. 1976).

[202] See comment 4 to Section 2-607 of the UCC.

[203] The awareness of the non-conformity by persons employed to perform the contract in question may be attributable to the seller. See V.G. Curran, 'Cross-References and Editorial Analysis (Article 40)' available at <http://cisgw3.law.pace.edu/cisg/text/cross/cross-40.html>.

[204] P. Schlechtriem, supra n.136 at p.322.

[205] V.G. Curran, supra n.203.

[206] Ibid at n.14.

on facts of which one 'could not have been unaware' does not impose a duty to investigate -- these are facts that are before the eyes of one who can see."[207] However, the seller must not ignore clues as to the non-conformity.[208]

The main issue concerning the application of Article 40, seems to be the determination of facts relating to non-conformity. In the leading case of *Beijing Light Automobile Co., Ltd v. Connell Limited Partnership*,[209] where the Chinese buyer failed to give proper notice of the non-conformity of a press, purchased from an American seller, within the guarantee period, the tribunal found that the seller could not rely on the lack of proper notification since he was aware of the risk of non-conformity. In this view, the awareness of the seller of facts related to the risk of non-conformity may be sufficient to make the seller's defence of the lack of proper notification of non-conformity unsuccessful.[210]

Nonetheless, Article 40 makes its effect subject to the lack of disclosure of the facts to which non-conformity relates. The main question here is that where the seller discloses such facts, is the buyer required to notify him of the non-conformity? The answer to this question depends on whether the buyer discloses the non-conformity or facts related to the risk of non-conformity. In case of the former, the buyer is not required to give a notice since the seller is already aware of the defect whereas the buyer still needs to notify the seller in case of the latter.[211]

Another issue here is concerned with the time of the seller's awareness of non-conformity. Article 40 does not provide a time frame. Such a time should be within the "reasonable time" of notification.[212] After this period, the buyer will not have the chance to notify the seller of the non-conformity. Consequently, the seller's awareness of the non-conformity through other means becomes irrelevant.

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[207] J.O. Honnold, supra n.75 at p.308.
[208] See *Stockholm Chamber of Commerce Arbitration Award* of 5 June 1998 (*Beijing Light Autmobile Co., Ltd v. Connell Limited Partnership*) <http://cisgw3.law.pace.edu/cases/980605s5.html>.
[209] *Stockholm Chamber of Commerce Arbitration Award* of 5 June 1998 <http://cisgw3.law.pace.edu/cases/980605s5.html>.
[210] *Stockholm Chamber of Commerce Arbitration Award* of 5 June 1998 (*Beijing Light Autmobile Co., Ltd v. Connell Limited Partnership*) <http://cisgw3.law.pace.edu/cases/980605s5.html>, section 6.3(b).
[211] P. Schlechtriem, supra n.136 at p.323.
[212] Ibid at p.323.

Conclusions

There seem to be some differences in applying the restrictions imposed on the recovery of damages under the SGA, the UCC and the CISG. One of the main differences between English and American law is concerned with the application of contributory negligence. The so-called comparative negligence under American law may be relied on to reduce the buyer's damages where part of the loss results from the buyer's intervening action. In English law, the defence of contributory negligence cannot be relied on in cases of broken 'strict contractual duty'. The Law Reform (Contributory Negligence) Act 1945 does not apply to cases of strict contractual duty. It is clear that the CNA does not apply to cases of defective goods as the seller's liability for breach of warranty of quality is strict. One here may note that where part of the loss results from the buyer's intervening action, it seems unclear why damages cannot be reduced. It seems that American law deals better with this point. It is submitted that liability for losses resulting from defective goods should be apportioned between the seller and the buyer according to their respective percentages of causation. In fact, this point may be of great significance for the application of the restriction of causation under the CISG. The application of such a restriction may be influenced by the domestic law of the country where the Convention is applied. For example, under French law, liability for all types of loss can be apportioned between the seller and the buyer according to their respective percentages of causation. This seems one of the gaps in the Convention which may lead to a difference in its application among the various legal systems.

As regards the remoteness principle, there seems to be no difference in its application under English law and the UCC. However, the CISG does not expressly state whether the principle applies as to the kind or the amount of loss. While *Hadley* and the UCC require the contemplation to be of the kind of loss, the wording of Article 74 of the CISG is wide enough to require the contemplation to be of the kind as well as the amount of loss. Therefore, the contemplation of the amount might be required under the Convention in cases where it is applied in countries which apply such a requirement under their domestic laws. In addition, the words of Article 74 are unclear in respect to whether the Article applies the subjective or the objective test of contemplation. The words are broad enough to include both tests. This is different from *Hadley* and the

UCC where the objective test applies. The objective test applies to hold the seller liable for losses which were in the reasonable contemplation of the parties at the time of making the contract. On the other hand, the subjective test applies to hold the seller liable for losses which were in the *actual* contemplation of the parties at the time of making the contract. It is unclear how the buyer can prove the *actual* contemplation of the seller. Here, it is submitted that the subjective test of remoteness, which is applied under the Convention, seems to be impractical.

English law, the UCC and the CISG seem to have, to some extent, similar application of the principle of mitigation. It is true that the UCC applies the principle to cases of consequential loss only. However, it was argued that under the American common law the principle is applicable to all cases of defective goods regardless of the type of loss caused by the breach. This chapter dealt with a number of ways of mitigation that should apply under the SGA, the UCC and the CISG similarly. Under the mitigation principle, the buyer may be required to stop using defective goods. However, this may not be the case where the continuity of using defective goods mitigates the buyer's loss. Generally, the buyer is not required to take unreasonable steps to mitigate his loss. Therefore, the buyer may not be required to accept the seller's offer to repair or replace defective goods where such a repair is delayed or cannot be helpful. Neither is the buyer required to accept the seller's offer to restore the contract price and take the goods back where such an offer is unreasonable to him.

Finally, the SGA, unlike the UCC and the CISG, does not apply the requirement of notification in cases where the buyer claims damages for losses resulting from defective goods. However, it has been seen how such a requirement is necessary especially in cases where the seller could settle the dispute outside the court or remedy the non-conformity of goods but for the lack of such a notification. The requirement of notification, it is submitted, should apply under English law. However, the period of notification should be wide enough to give the buyer the chance to determine the nature of non-conformity and seek legal advice. It has been seen how the period of notification is short in some countries, such as Germany, and relatively long in others, such as the USA.

The use of the term "reasonable time" under the Convention allows the influence of domestic laws. To avoid such an influence, two points are submitted: firstly, the parties may include in their contract express clauses which specify the period of notification. Secondly, the courts should examine cases decided under different legal systems in order to minimize the influence of domestic laws. Here, decisions decided by the ICC International Court of Arbitration are best to be examined in the light of the fact that they are less influenced by domestic laws. Any way, the requirement of notification may not apply in certain cases, such as the case where the seller is actually aware of the nature of defective quality. Under Article 44 of the Convention, the buyer may be excused from giving proper notice in certain cases. The Article has been designed to protect buyers from developing countries who may find it hard to comply with the requirement of notification.

Chapter Eight

Conclusions

At this last part, it is intended to provide general conclusions for the underlying argument of whether the law strikes the right balance in applying the principle of *Robinson v. Harman*[1] and whether such a principle is undermined by applying, or misapplying, other principles concerned with the remedy of damages. After stating the general conclusion, which is comprised of two parts, one needs to show how such conclusions have been reached, whether under English or American law, in reliance on the points raised in this thesis.

Firstly, English law, in allowing damages for breach of warranty of quality, has, to some extent, succeeded in striking the right balance by achieving the objective of damages, as stated in *Robinson,* and at the same time ensuring that the buyer is not overcompensated. However, English law needs to pay more attention to certain points in order to avoid overcompensating the buyer. Suggestions and formulas are submitted below in order to ensure that the balance is always achieved in cases of defective goods. Although the same objective of damages can be found under American law, American courts, it is submitted, have failed to achieve the right balance, as illustrated below.

Secondly, the application of the principle of *Robinson*, it is submitted, is undermined due to the application, or misapplication, of certain principles concerned with the recoverability of damages. This has lead to undercompensation of the buyer by disallowing him to recover damages for certain types of loss. By this way, English law, it is submitted, fails to achieve the objective of damages by improper application of other principles of law. American law seems to face similar problems.

As regards the second part of the conclusion, the most obvious areas where the application of the principle of *Robinson* is undermined are non-pecuniary losses and loss of profit. Under both English and American law, the buyer is not entitled to recover more than his lost expectations even though his reliance expenses are more than his

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[1] (1848) 1 Exch 850, 855. Supra, p.1.

expectations. This can be understood from the rule that the aggrieved party should not be put in a better financial position than the position he would have been in if the contract had been performed properly. In this sense, the buyer should not be entitled to recover both his lost expectations and wasted reliance expenses since reliance expenses normally comprise part of the expectations. Therefore, the buyer should not be allowed his lost gross earnings and wasted reliance expenses. However, this should not apply where the buyer seeks recovery of his wasted capital expenses and lost *net* profit. Gross earnings are normally comprised of net profit and capital expenses. It can be noted that reliance expenses are part of the buyer's expectations unless the buyer has made a bad bargain, i.e. where the expectations are less than the capital expenses. Indeed, the buyer will not obtain double recovery by allowing him his lost net profit and wasted capital expenses. The application of the rule, i.e. the buyer is not entitled to recover for both lost expectations and wasted reliance expenses, should be confined to cases where the buyer claims his lost gross earnings and wasted capital expenses. English law should pay more attention to this point. The obvious example, where the court failed to achieve the objective of damages due to its failure to distinguish between gross earnings and net profit, is the case of *Cullinane v. British "Rema" Manufacturing Co. Ltd.*[2] In this case, the buyer was not permitted to claim both his wasted capital expenses and lost net profit caused by defective profit-making machinery. It is submitted that the misapplication of the principle that the buyer is not entitled to recover both his lost expectations and wasted reliance expenses has undermined the application of the principle of *Robinson* by failing to place the buyer in the same position as if the goods had been free from defects.

The wrong reliance on the distinction between reliance expenses and expectations may undermine the objective of damages. This can be the case of wasted pre-contract expenses under American law. Under American law, damages for wasted pre-contract expenses are still unrecoverable. American courts justify such an attitude on the grounds that pre-contract expenses are not part of reliance expenses. However, the classification of reliance and expectations, it is submitted, should not prevent the recovery for losses resulting from a breach of contract. Moreover, pre-contract expenses can be part of the buyer's expectations where the buyer makes a good bargain since the buyer, in such a case, makes enough profit to recover his pre-contract expenses. If wasted pre-contract

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[2] [1954] 1 QB 292.

expenses can be recovered as part of the buyer's damages for lost expectations, there should be no point in disallowing their recovery where they are claimed independently. Therefore, contrary to Ogus, damages for wasted pre-contract expenses should be allowed under the normal restrictions imposed on the recovery of damages. Ignoring such a loss will result in undermining the objective of damages where the only loss of the buyer is the wasted pre-contract expenses. Under English law and the CISG, such damages are generally recoverable. Indeed, under the CISG, damages can be recovered for all foreseeable losses resulting from the breach. In comparing English law with American law and the CISG, one may note that English law and the CISG deal better with cases where the buyer seeks recovery of his wasted pre-contract expenses.

The application of the principle of *Robinson* is also undermined in the area of non-pecuniary loss due to the application of the "general non-recoverability rule" in cases of certain types of non-pecuniary damage, such as disappointment and mental distress. In fact, money award may not remedy the buyer's feelings injury. However, damages are the only available remedy for such a damage. Damages should be awarded in order to compensate the buyer for such a damage. If the goods had been free from defects, the buyer would not have suffered such a damage. Therefore, the principle of *Robinson* should apply in order to place the buyer, *so far as money can do it,* in the same position he would have been in had the goods been free from defects. Although English law allows damages for physical inconvenience under the normal restrictions, it seems to confine the recovery of damages for mental distress and other intangible losses to certain cases. Damages for such losses can be recovered in cases where the contract is intended to provide mainly pleasurable amenity and freedom from distress or where mental distress is consequent on personal injury or physical inconvenience caused by the breach of contract. However, one here may argue that the objective of damages cannot be achieved without compensating the buyer for such types of damage under the normal restrictions imposed on the recovery of damages. The "general non-recoverability rule" under English law should be abolished. If damages for physical inconvenience can be generally awarded, one may question why damages for mental distress cannot be generally awarded. The emotional status should be treated as part of the body. Indeed, in view of the recent decision of the House of Lords in *Malik v. BCCI,*[3] it can be noted that English law seems to be moving towards abolishing the "general non-recoverability

[3] [1998] AC 20.

rule" in cases of intangible losses. Nevertheless, as the law stands at present, the application of the "general non-recoverability rule" undermines the application of the principle of *Robinson*.

Nevertheless, English courts seem to be less unsuccessful than American courts in achieving the objective of damages in cases of non-pecuniary losses due to the application of the "general non-recoverability rule" to both cases of physical inconvenience and mental distress. English law seems to deal better than American law with cases of physical inconvenience. Whilst damages for physical inconvenience are generally recoverable under English law, American law allows such damages only where the physical inconvenience is severe. The American approach is in contradiction with the purpose of damages under Section 2-714 of the UCC. Under this Section, damages should be allowed for the losses caused by breach of warranty taking into account the normal restrictions imposed on the recovery of damages.

However, under American law, the objective of damages is less undermined in cases of mental distress. American law has gone a step forward in cases where the buyer claims damages for mental distress or other intangible losses. Although both English and American law apply the "general non-recoverability rule", the latter has gone a step forward to consider the severity of mental distress in deciding the recoverability of damages. American law applies the same exceptions that can be found under English law. In addition, under the American Restatement (Second) of Contracts damages for mental distress can be allowed where the breach is of such a kind that serious emotional disturbance was a particularly likely result. Nevertheless, although American law seems to deal better with cases of mental distress, neither English law nor American law has gone far enough to provide for the general recoverability of damages for intangible losses. Comparing with the CISG does not provide help in this area. The recoverability of damages for non-pecuniary losses seems to be beyond the scope of its application. Comment 3 to Article 74 makes it clear that the purpose of damages is to compensate the aggrieved party for his financial loss. This may be understandable on the ground that intangible losses are analogous to bodily injury for which damages cannot be recovered. Article 5 of the Convention excludes liability for personal injury and death from the scope of the Convention. Arguably, the recoverability of damages for the buyer's liability to his sub-buyer, who suffered personal injury, is most likely beyond the scope

of the Convention. This seems to be a suitable regime in the international trade field since such a liability widely varies among the several legal systems.

Another area, where the objective of damages is undermined under American law, is loss of profit of new business. The "new business rule" applies under American law in order to disallow damages for loss of new business profit. However, such a rule should be regarded as a rule of evidence and not of law. Where loss of profit is proved, damages should be allowed under the normal restrictions. Whilst the uncertainty as to the fact of loss of profit is fatal, it is not as to the amount of loss of profit. English law does not face such a problem. It can be noted that English law deals better with the remedy of damages in cases of loss of profit of new business.

Turning back to the first part of the general conclusion, i.e. English law strikes the right balance in achieving the objective of damages, as stated in *Robinson,* and ensuring that the buyer is not overcompensated. In order to keep such a balance, three points should be considered. Firstly, the court, in applying the principle of *Robinson*, should look at the potential end-result of a *proper* performance of the contract. Secondly, the court should consider the actual position that the buyer is placed in due to the breach of warranty of quality. Thirdly, in order to avoid overcompensating or undercompensating the buyer, the court should consider the buyer's actual loss resulting from breach of warranty of quality. In fact, the UCC and the CISG allow damages for the losses resulting from the breach. However, the buyer under all of the SGA, the UCC and the CISG should not be allowed for more than his actual loss. In determining the actual loss, one has to consider the profit derived from the breach.

The first point can justify why the *prima facie* measure should consider the value at the time of acceptance and not the time of delivery. The *end-result* of proper performance of the contract is to deliver conforming goods *which can continue being conforming in performing their potential use*. It is unlikely for the buyer to discover the defect in the goods until he receives them. Therefore, it is more logical, in applying the *prima facie* measure, to consider the value of the goods at the time of acceptance. In fact, the *prima facie* measure under the SGA considers the value of the goods at the time of delivery while under the UCC the goods are valued at the time of acceptance. Nevertheless, this may not create any difference in the application of the *prima facie* measure under

English and American law since the goods are normally valued at the time when the buyer has a reasonable chance to discover the defect of the goods. Therefore, where the buyer has passed the goods to a sub-buyer without examining them and the seller was aware or should have been aware, of the subsale, goods should be valued at the time of discovery of the defect by the sub-buyer. Similarly, where the seller caused a delay in the resale of the defective goods, the goods will be valued at the time of resale.

A significant example on the first point, i.e. the potential end-result of proper performance of the contract, is the case of profit-making goods. In such cases, damages should not be quantified under the *prima facie* measure. In applying the principle of *Robinson* in cases where the buyer uses the goods for their commercial life, the court should look at the potential gross earnings that the buyer could have gained but for the breach. In order to consider the potential end-result of proper performance of the contract, the court has to consider also the potential profit that could have been gained by investing the potential annual earnings for the commercial period of the goods. In such a case, the buyer is entitled to recover the difference between the potential net profit and the actual net profit that the buyer gained by using the goods as delivered. In addition, the buyer may be entitled to damages for the loss of chance of investing the annual earnings for the period of the commercial life of the goods. Net profit can be quantified under the following formula:

> *[(the total earnings of the goods during their commercial life + the residual value of the goods at the end of their commercial life) less the contract price of the plant and any further expenses incurred in reliance on the contract]*

In order to strike the right balance by achieving the objective of damages, as stated in *Robinson,* and ensuring that the buyer is not overcompensated, the second point mentioned above, i.e. the actual position that the buyer is placed in as a result of the breach, should be considered, especially in cases where the buyer suffers loss of production. In fact, the actual position that the buyer is placed in may indicate the buyer's actual loss. In cases of profit-making goods, the buyer should not be entitled to recover for both the diminution in value of the goods supplied and loss of production since by doing so, the buyer will be overcompensated. Damages should be allowed for the actual loss of the buyer, i.e. loss of production. However, the buyer should not be entitled to recover such damages where he has repaired or replaced the goods. In such a

case, the buyer's actual loss is the diminution in value or cost of repair. In such a case, the application of the principle of *Robinson* may overcompensate the buyer. The buyer should be entitled to recover damages for his actual loss only. The same result can be reached by applying the mitigation principle, which applies to disallow damages for losses that have been, or could have been, avoided. Therefore, where the buyer stopped using the defective goods in order to mitigate his loss, he may be entitled to recover the loss of net profit during the period of using the goods plus his loss of gross earnings for the remaining period of the commercial life of the goods after subtracting the running expenses which would have been incurred if the goods had operated as warranted. In such a case, the buyer's damages under the principle of *Robinson* should be reduced in order to allow the buyer damages for his actual loss and, as a result, ensure that he is not overcompensated.

As regards the third point mentioned above, i.e. the actual loss resulting from breach of warranty of quality, the court, in applying the principle of *Robinson,* may avoid overcompensating the buyer by reducing his damages by the amount gained from the breach. For example, the court may reduce the buyer's damages by the amount gained by using superior substitute goods. Where the buyer gains from the breach by obtaining a substitute of superior capacity, the extra profit gained should be deducted from his damages in order to allow him the same economic end-result of delivering conforming goods. In such cases, the following formula is submitted to be considered for the quantification of damages:

> (*[cost of replacement + extra expenses incurred in using defective goods] – [the salvage value of the defective goods + extra profit derived from the superiority of the substituted goods]*).

In addition, in determining the buyer's actual loss in cases where the defective goods cause delay in the operation of a business, the court should take into account the profit gained by investing the capital during the period of delay. In allowing the buyer damages under the principle of *Robinson,* the buyer's damages should be reduced by the amount gained by freeing the capital during the period of delay. Based on the analysis of Williamson, the following formula may apply.

> {[(*total expected percentage on return on capital - the percentage on actual return*) *x* (*capital investment*)] *x number of years of recovery period.*}

A similar conclusion should be reached where the substituted goods are of a longer commercial life than the remainder of the potential commercial life of the replaced goods. In such cases, the buyer will have the chance to invest the price of a new machine between the time of expiry of the supposed commercial life of the replaced machine and the end of the commercial life of the substituted machine. Profits derived from investing the price for such a period should be deducted from the buyer's damages. However, the court may not be convinced that the buyer will use the substituted goods for all their commercial life; in such a case, the court may disregard the commercial life of the substituted goods for the purpose of calculation of damages as in the case of *Bacon v. Cooper (Metals) Ltd.*[4] Nevertheless, the court, it is submitted, should pay more attention to the commercial life of substitute goods in order to avoid overcompensating the buyer.

On the other hand, considering the buyer's actual loss may increase the buyer's damages. In general, the principle of *Robinson* applies objectively unless special circumstances indicate otherwise. Therefore, the buyer in normal circumstances recovers damages for the diminution in the objective value of goods. The objective value can be measured by the market value or the contract price, as explained in this research. However, the subjective value of the proper performance of the contract may be more than the objective value. In order to allow damages for the buyer's actual loss, the subjective value of the goods should be considered as long as such a value was, or should have been, in the contemplation of the parties at the time of making the contract. Therefore, in principle, loss of 'consumer surplus' is recoverable as long as the buyer cannot avoid such a loss by obtaining substitute goods or curing the defect. This should apply similarly under the SGA, the UCC and the CISG although the CISG does not expressly state the *prima facie* measure of damages. However, where the value of the goods fluctuates, the *prima facie* measure may apply under the CISG in order to allow the buyer damages for the diminution in the objective or subjective value of the goods. In fact, the subjective valuation may be in favour of the seller where he can prove that the defective goods are of more value in the eye of the buyer than their objective value. Therefore, ignoring the subjective value may overcompensate or undercompensate the buyer and, as a result, the required balance in awarding damages under the principle of *Robinson* may be affected.

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[4] [1982] 1 All ER 397.

In fact, the actual loss of the buyer may be considered in order to allow the buyer more damages than the damages he is entitled to recover under the principle of *Robinson.* This can be the case where the repair or replacement increases the value of the goods. Of course, this does not happen in cases of profit-making goods since the buyer's damages should be reduced by the amount of profit derived from the improvement of the goods. In certain cases, such as secondhand goods, the repair may improve the quality of goods. If substitute goods are not available, repair becomes the only way to deal with the defect of the goods. In such a case, it can be argued that the actual loss of the buyer is the cost of repair even though such a cost exceeds the diminution in value. However, the buyer may not be expected to cure the defective goods where the cost of cure is very disproportionate to the difference in value. In such a case, it seems unfair to allow the buyer damages calculated on the basis of the cost of cure. Therefore, as decided by the House of Lords in *Ruxley Electronics and Construction Ltd. and another v. Forsyth*,[5] the buyer should not be entitled to recover the cost of cure where it is unreasonable to cure the defective performance. At any case, the buyer should not be entitled to more than the cost of cure since such a cost represents his actual loss. However, this does not apply where the cure makes the goods of less quality than the contractual quality. In such a case, the buyer's actual loss is the cost of cure plus the difference between the cost of cure and the value of the goods that they would have had if they had been in conformity with the contract.

The principles of betterment and reasonableness are necessary to avoid overcompensating or undercompensating the buyer under the principle of *Robinson.* In addition, in order to measure the buyer's actual loss, subsale contracts should be considered in assessing the buyer's damages provided that the subsale was in the reasonable contemplation of the parties at the time of making the contract. English law has recently developed in the right direction by considering subsale contracts in quantifying the buyer's damages for breach of warranty of quality. Goods may be purchased in order to be used as ingredients for producing other products. If the products are discovered defective by sub-buyers, the buyer's damages will be quantified on the basis of his liability to his sub-buyer provided that the seller was aware, or should have been aware, at the time of making the contract, of the fact that the goods will be

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[5] [1996] 1 AC 344.

manufactured. This is due to the fact that the buyer's actual loss is his liability to sub-buyers. This is the current position of English law, as stated in *Bence Graphics International Ltd. v. Fasson UK Ltd.*[6] Of course, the buyer's damages will be quantified differently if the goods are discovered defective before manufacturing them or the products are discovered defective before selling them. In the former case, the buyer will be entitled to recover damages for the diminution in value of the goods whilst in the latter case he will be entitled to damages for the diminution in value of the products. In such cases, if the buyer cannot obtain a substitute, he may also be entitled to recover for his liability to sub-buyers.

It can be pointed out that the decision in *Bence* confirms that the buyer should not be entitled to recover more than his *actual* loss. Moreover, one may argue that the objective of damages, as stated in *Robinson*, can be achieved by allowing the buyer damages for his liability to sub-buyers. In applying the principle of *Robinson*, one should look at the potential economic end-result of the proper performance of the contract. If the goods had been delivered as warranted, the buyer would have manufactured them and successfully delivered the products to sub-buyers. Damages should be awarded in order to put the buyer in such a position unless the buyer discovers the defect before manufacturing the goods or selling the products. Here, the buyer may be able to mitigate his loss by not manufacturing the goods or by not selling the products. Therefore, it can be argued that the award in a case such as *Bence* can be made in reliance on the principle of *Robinson.* A similar conclusion should be reached in cases where the buyer purchases goods for resale. If the buyer successfully performed resale contracts, he should be entitled to no more than nominal damages since he suffered no actual loss. Thereupon, contrary to Treitel, it is submitted that the case of *Slater v. Hoyle & Smith Ltd*[7] was wrongly decided.

To sum up, the buyer should not be allowed damages for more than his actual loss. The court, in applying the principle of Robinson, should consider the end-result of proper performance of the contract. In other words, the court should consider the potential outcome of using the goods if they had been in conformity with the contract provided that the seller was aware, or should have been aware, at the time of making the contract

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[6] [1997] 1 All ER 979.
[7] [1920] 2 KB 11.

of the potential use of the goods. For example, the direct result of proper performance, i.e. delivery of conforming goods, should be ignored where the seller was aware, or should have been aware, at the time of making the contract that the goods were bought to be used in profit-making business. By this way, the court can strike the right balance by achieving the objective of damages, as stated in Robinson, and at the same time ensuring that the buyer is not overcompensated.

Although damages should be quantified under the SGA, the UCC and the CISG similarly, American courts seem to be less successful than English courts in allowing the buyer damages for his actual loss. *There should be a distinction between the negative results of the breach and the actual loss resulting from the breach.* For example, in cases where the goods are bought in order to be manufactured, breach of warranty of quality may cause a diminution in value of the goods supplied, a diminution in value of the products manufactured and a buyer's liability to sub-buyers. However, these negative results should not be considered as actual losses resulting from breach of warranty of quality. The buyer's actual loss depends on the stage when the defect is discovered as discussed above. In fact, in a number of UCC cases, such as the famous case of *Durham v. Ciba-Geigy Corp.*,[8] the buyer was allowed damages for the diminution in value of the seeds or herbicides and the diminution in value of the crops. The buyer's actual loss is the diminution in value of the crops since the seeds and herbicides are usually used in any case to produce the crops. Under the CISG, damages should be allowed for the buyer's actual loss caused by the seller's breach. Due to the relatively small number of cases decided under the CISG in the area of damages for defective goods, it does not seem possible to compare the practice of quantifying damages under the Convention with the practice of English and American courts in this area. However, the problems that exist in English and American law regarding the quantification of damages may be avoided under the Convention by considering the aforementioned methods of assessment of damages.

In general, where the buyer's loss is less than what the buyer has gained by not performing the contract properly, the seller may gain from his breach by allowing the buyer damages calculated on the basis of his actual loss. On the other hand, by allowing the buyer restitutionary damages, i.e. damages calculated on the basis of the seller's gain

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[8] 1982 S.D. LEXIS 262; 33 UCC Rep. Serv. 588 (1982).

from the breach, the buyer will be overcompensated. The same result may be reached where the buyer is allowed price reduction as stated under the CISG. The amount of price reduction is not quantified on the basis of the buyer's loss. Under English law, consumers will be able to claim price reduction under certain restrictions after the implementation of the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees. In order to avoid overcompensating the buyer or allowing the seller to gain from his breach, it is submitted that there should be a legislative intervention in order to apportion the windfall between the parties.

Clearly, before quantifying the buyer's damages, the court discusses whether the damages claimed are recoverable and, in many cases, whether the buyer has a cause of action. The principle of *Robinson* is concerned with the recoverability and quantification of damages since it aims at placing the innocent party, so far as money can do it, in the same situation as if the contract had been properly performed. However, damages recoverable under the principle of *Robinson* can be reduced or denied by the application of other principles developed by the common law, such as remoteness and mitigation. English courts should pay more attention to the restriction of causation in allowing damages for 'loss of the right to reject'. The buyer should not be entitled to recover under the principle of *Robinson* for losses resulting from the buyer's acceptance of the goods and not from his loss of the right to reject documents. In general, there seem to be no material differences in the application of these principles under English law, the UCC and the CISG. However, the remoteness principle does not apply under the UCC to cases of physical loss. In such cases, damages can be recovered as long as the loss is proximately caused by the defective goods. This seems to leave the seller in an insecure position since he may be held liable for remote losses resulting under special circumstances. As a result, this may increase the costs since the insurance will be higher. It is submitted that the remoteness principle should restrict the recovery of damages for all types of loss. This is the position under English law and the CISG.

By allowing the buyer damages for his loss, the restriction of mitigation can be satisfied. Where the buyer has mitigated his loss, damages recoverable under the principle of *Robinson* should be reduced in order to avoid compensating the buyer for the avoided loss, i.e. in order to avoid overcompensating the buyer. In fact, by allowing the buyer damages for his actual loss, the buyer will not be entitled to recover for his avoided loss.

Therefore, this function of the mitigation principle is already taken into account by allowing the buyer damages for his actual loss. However, the application of the principle of mitigation is still significant since it reduces the buyer's damages under the principle of *Robinson* by disallowing him damages for losses which could reasonably have been avoided.

The main difference between English law and the UCC is the defence of lack of privity. Due to this defence, the buyer may be left uncompensated and the remote seller may escape liability for losses caused by the defective quality of goods. Under the *current* English law, the ultimate buyer seems to have no action in contract against the producer of the goods. Where the retailer has disappeared or become insolvant, the buyer may be left uncompensated for his loss. The Law Commission Report, on which the Contracts (Rights of Third Parties) Act 1999 is based, makes it clear that the Act does not provide much help in cases of chain contracts. However, the Law Commission Report makes it clear that the 1999 Act may offer the third party beneficiary, who was expressly identified at the time of making the contract, the right to sue the retailer for defective goods. The requirement of *express identification*, it is submitted, leads to unfair results in certain cases. The third party beneficiary should have an action against the retailer where the circumstances of the case reasonably indicate that the goods are bought for a third party. Furthermore, the ultimate buyer should be entitle to recover damages from the remote seller where such a seller was aware, or should have been aware, of the fact that the goods will be resold to the ultimate buyer. English courts should go beyond the 1999 Act, at least in cases where the chain of contract is broken, in order to prevent the manufacturer escaping liability and at the same time ensure that the ultimate buyer is not left uncompensated.

In comparison, American law is more flexible in applying the defence of lack of privity. In fact, under several American jurisdictions, such a defence does not apply to cases where the ultimate buyer sues the manufacturer for losses resulting from defective goods. Under the UCC, retailer's implied or express warranty may extend to third party beneficiary. Under the draft of revised Article 2 of the UCC, the manufacturer's express warranty addressed to the ultimate buyers or end-users is legally enforceable. English law seems to deal with such a defence differently. The enforceability of express warranties issued by the remote seller to the ultimate buyer is open to debate. Although

the prevailing view is that such warranties are legally binding, the issue is still controversial. Such warranties are normally binding where they furnish a ground for a collateral contract. Under the EC Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, certain guarantees issued by the producer to consumers are legally binding. Currently, American law seems to deal better with the liability of remote seller and the liability of the retailer to third party beneficiary. However, the position in English law is likely to change in the near future. The EC directive will be reviewed with respects to the producer's liability. Unfortunately, if a provision for the producer's liability is added under the EC Directive, it will be confined to consumer cases and, most likely, will not provide for the remedy of damages. English law should go farther than that by relaxing the requirement of privity where the third party beneficiary sues a retailer or the ultimate buyer or end-user sues the remote seller.

Finally, it can be noted that the buyer's actual loss should always be the starting point in determining the buyer's compensatory damages for breach of warranty of quality. Not all the negative results of the breach should be considered in quantifying the buyer's damages. In applying the principle of Robinson, the court should consider the economic end-result of proper performance and the actual position that the buyer is placed in due to the defective performance. In order to avoid undermining the principle of Robinson, the court should award damages for all the actual loss caused by the defective quality of goods, taking into account the normal restrictions imposed on the recovery of damages. By applying the methods of quantification submitted above, the issue of overcompensation or undercompensation will be extremely unlikely to arise.

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Ala: Alabama; Alas: Alaska; Ariz: Arizona; Ark: Arkansas;
Colo: Colorado; Conn: Connecticut; Del: Delaware; D.Colum: District of Columbia;
Fla: Florida; Ga: Georgia; H: Hawaii; Ida: Idaho;
Ill: Illinois; Ind: Indiana; Iowa: Iowa; Kan: Kansas;
Ky: Kentucky; La: Louisiana; Md: Maryland; Mich: Michigan;
Minn: Minnesota; Miss: Mississippi; Mo: Missouri; Mont: Montana;
Neb: Nebraska; Nev: Nevada; N.J: New Jersey; N.M:New Mexico;
N.Y: New York; N.C: North Carolina; N.D: North Dakota; Ohio: Ohio;
Okla: Oklahoma; Ore: Oregon; Pa: Pennsylvania; S.C: South Carolina
S.D:South Dakota; Tenn: Tennessee; Tex: Texas; Utah: Utah;
Va: Virginia; Vt: Vermont; Wash: Washington; Wis: Wisconsin;
Wyo: Wyoming; Alab: Alabama; Alas: Alaska; Ariz: Arizona;
Ark: Arkansas; Colo: Colorado; Conn: Connecticut; Del: Delaware;
D.Colum: District of Columbia; Fla: Florida; Ga: Georgia;
H: Hawaii; Ida: Idaho; Ill: Illinois; Ind: Indiana;
Iowa: Iowa; Kan: Kansas; Ky: Kentucky; La: Louisiana;
Md: Maryland; Mich: Michigan; Minn: Minnesota; Miss: Mississippi;
Mo: Missouri; Mont: Montana; Neb: Nebraska; Nev: Nevada;
N.J: New Jersey; N.M: New Mexico; N.Y: New York; N.C: North Carolina;
N.D: North Dakota; Ohio: Ohio; Okla: Oklahoma; Ore: Oregon;
Pa: Pennsylvania; S.C: South Carolina; S.D:South Dakota; Tenn: Tennessee;
Tex: Texas; Utah: Utah; Va: Virginia; Vt: Vermont;
Wash: Washington; W. Va: West Virginia; Wis: Wisconsin; Wyo: Wyoming;
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